

No. 15031

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United States  
Court of Appeals  
for the Ninth Circuit

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Estate of HERBERT B. MILLER, Deceased,  
UNITED STATES NATIONAL BANK OF  
PORTLAND, (Oregon), Administrator, d.b.n.,  
c.t.a.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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Transcript of Record

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Petitions to Review Decisions of The Tax Court  
of the United States.

FILED

APR 24 1956

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

McCARTY, SWINDELLS, MILLER AND  
McLAUGHLIN, by  
GEORGE W. MILLER,  
Public Service Bldg.,  
Portland 4, Oregon,  
For Petitioner.

CHARLES K. RICE,  
Acting Asst. Attorney General;  
LEE A. JACKSON,  
Tax Division, Dept. of Justice,  
Washington 25, D. C.,  
For Respondent.





The Tax Court of the United States

Docket No. 28582

Estate of HERBERT B. MILLER, Deceased,  
UNITED STATES NATIONAL BANK OF  
PORTLAND, (Oregon), Former Executor,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Amended to Read

Estate of HERBERT B. MILLER, Deceased,  
THE UNITED STATES NATIONAL BANK  
OF PORTLAND (Oregon), Administrator,  
d.b.n., c.t.a.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

See Order of 12/28/50.

DOCKET ENTRIES

1950

May 29—Petition received and filed. Taxpayer notified. Fee paid.

June 1—Copy of petition served on General Counsel.

1950

- July 17—Motion to dismiss for failure properly to prosecute, filed by General Counsel.
- July 18—Hearing set Aug. 3, 1950, on Respondent's motion.
- Aug. 3—Hearing had before Judge Kern on respondent's motion to dismiss, upon oral request of petitioner proceeding continued.
- Aug. 3—Order, hearing on respondent's motion to dismiss is continued to 9/6/50, Washington, D. C., entered.
- Sept. 1—Motion for leave to file attached amended petition, amended petition lodged, filed by taxpayer.
- Sept. 6—Hearing had before Judge Kern on respondent's motion to dismiss, denied.
- Sept. 6—Order, that respondent's motion to dismiss is denied, petitioner's motion is granted, amended petition is filed this date, entered.
- Sept. 7—Copy of order, motion and amended petition served on General Counsel.
- Sept. 27—Motion to dismiss for lack of jurisdiction filed by General Counsel.
- Oct. 20—Hearing set Nov. 8, 1950, on respondent's motion.
- Nov. 6—Motion for continuance to early part of December, 1950, filed by taxpayer. Granted to December 6, 1950.

1950

- Dec. 5—Motion for leave to file the attached second amended petition, second amended petition lodged, filed by taxpayer.
- Dec. 5—Order, petitioner's motion is granted and amended petition filed this date, respondent's motion to dismiss filed Sept. 27/50, is denied, proceeding stricken from Dec. 6, 1950, calendar entered.
- Dec. 5—Second amended petition filed by taxpayer.
- Dec. 8—Copy of order, motion and second amended petition served on General Counsel.
- Dec. 28—Answer filed by General Counsel.
- Dec. 28—Request for hearing in Portland, Oregon, filed by General Counsel.
- Dec. 28—Motion to change caption filed by respondent.
- Dec. 28—Order, that caption is changed to read: "Estate of Herbert B. Miller, deceased, The United States National Bank of Portland (Oregon), Administrator, d.b.n., c.t.a.," entered.

1951

- Jan. 3—Notice issued placing proceeding on Portland, Oregon, calendar. Service of answer and request made.

1952

- Apr. 15—Hearing set June 30, 1952, Portland, Oregon.
- May 14—Entry of appearance of David S. Pattullo and George W. Miller, as counsel filed.

1952

May 14—Motion for continuance filed by taxpayer.  
5/15/52. Granted.

1953

Mar. 23—Hearing set July 6, 1953, Portland, Oregon.

June 10—Motion to continue from the July 6, 1953, Portland calendar filed by petitioner.  
6/11/53. Granted.

1954

June 29—Hearing set Oct. 11, 1954, Portland, Oregon.

Oct. 11 &amp;

Oct. 12—Hearing had before Judge Raum on the merits, petitioner's oral motion to consolidate with docket 31063—Granted. Stipulation of facts filed, Petitioner's brief due Nov. 26, 1954; Respondent's brief due Dec. 27, 1954; petitioner's reply due Jan. 17, 1955.

Oct. 29—Transcript of Hearing 10/11/54 filed.

Nov. 22—Motion for extension to 1/3/55 to file Petitioner's Brief; 2/2/55 to file Respondent's Brief; 2/22/55 Petitioner's Reply Brief, filed by taxpayer. 11/23/54—Granted.

1955

Jan. 3—Motion for extension to 1/10/55 to file Petitioner's Brief; Respondent's Brief 2/9/55, and until 3/1/55 to file Reply Brief, filed by taxpayer. 1/3/55—Granted.

Jan. 10—Brief filed by taxpayer. Copy served.

1955

- Jan. 25—Motion for extension to Feb. 28, 1955, to file answer brief filed by General Counsel. 1/27/55—Granted.
- Feb. 28—Answer Brief filed by General Counsel.
- Mar. 14—Motion for extension to April 1, 1955, to file reply brief, filed by taxpayer. 3/23/55—Granted.
- Apr. 4—Reply Brief filed by taxpayer. 4/4/55. Copy served.
- Aug. 23—Findings of Fact and Opinion filed. Judge Raum, Decision will be entered for the respondent. Copy served.
- Aug. 24—Decision entered, Judge Raum, Div. 11.
- Nov. 17—Petition for review by U. S. Court of Appeals for the Ninth Circuit, filed by petitioner.
- Nov. 21—Proof of Service filed.
- Dec. 6—Statement of Points with acknowledgment of service thereon, filed by petitioner.
- Dec. 6—Designation of Contents of Record with acknowledgment of service thereon, filed by petitioner.
- Dec. 7—Designation of Additional Portions of Record with statement of service by mail thereon filed by respondent.
- Dec. 20—Order extending time to Feb. 15, 1956, for filing the record and docketing the appeal, entered.

The Tax Court of the United States

Docket No. 31063

Estate of HERBERT B. MILLER, Deceased,  
 THE UNITED STATES NATIONAL BANK  
 OF PORTLAND (Oregon), Executor of Said  
 Estate, Administrator De Bonis Non With Will  
 Annexed of Said Estate, as Distributee-Trustee  
 of Said Estate, and Individually,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
 Respondent.

Estate of HERBERT B. MILLER, Deceased,  
 THE UNITED STATES NATIONAL BANK  
 OF PORTLAND (Oregon), Administrator,  
 d.b.n., c.t.a.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
 Respondent.

Amended Caption 1/17/51.

## DOCKET ENTRIES

1950

Oct. 19—Petition received and filed. Taxpayer notified. Fee paid.

Oct. 20—Copy of petition served on General Counsel.

1950

- Dec. 12—Motion to change caption filed by General Counsel.
- Dec. 12—Answer filed by General Counsel.
- Dec. 12—Request for hearing in Portland, Oregon, filed by General Counsel.
- Dec. 14—Hearing set Jan. 17/51, Washington, D. C., on respondent's motion.
- Dec. 19—Notice issued placing proceeding on Portland, Oregon, calendar. Service of answer and request made.

1951

- Jan. 17—Hearing had before Judge Kern on respondent's motion to change caption—Granted.
- Jan. 17—Order amending caption to read "Estate of Herbert B. Miller, Dec'd, The United States National Bank of Portland (Oregon), Administrator, d.b.n., c.t.a.," petitioner, entered.

1952

- Apr. 15—Hearing set June 30, 1952, Portland, Oregon.
- May 14—Motion for continuance filed by petitioner. 5/15/52—Granted.

1953

- Mar. 23—Hearing set July 6, 1953, Portland, Oregon.
- June 10—Motion for a continuance filed by taxpayer. 6/11/53—Granted.

1954

- June 29—Hearing set October 11, 1954, Portland, Oregon.
- Oct. 11 &
- Oct. 12—Hearing had before Judge Raum on the merits on Petitioner's oral motion to file amended petition, no objection by respondent, and on Petitioner's oral motion to consolidate dockets 28582 and 31063. Both motions granted, Respondent given 10 days to file reply. First amended petition —(Copies served), and Stipulation of Facts filed at hearing, Petitioner's brief due 11/26/54; Respondent's brief due 12/27/54 and Petitioner's reply due 1/17/55.
- Oct. 11—Copy of first amended petition served on General Counsel.
- Oct. 18—Answer to first amended petition filed by General Counsel, at Portland, Oregon.
- Oct. 18—Copy of answer to first amended petition, filed at Portland, Oregon, served.
- Oct. 29—Transcript of Hearing 10/11/54 filed.
- Nov. 22—Motion for extension to Jan. 3, 1955, for Petitioner's Brief; Feb. 2, 1955, for Respondent's Brief; and Feb. 22, 1955, to file Petitioner's Reply Brief filed by taxpayer. 11/23/54—Granted.



1955

- Jan. 3—Motion for extension to 1/10/55 for Petitioner's Brief, 2/9/55, Respondent's Brief, and until 3/1/55 for Reply Brief, filed by taxpayer. 1/3/55—Granted.
- Jan. 10—Brief filed by taxpayer. Copy served.
- Jan. 25—Motion for extension to Feb. 28, 1955, to file answer brief filed by General Counsel. 1/27/55—Granted.
- Feb. 28—Answer Brief filed by General Counsel.
- Mar. 14—Motion for extension to file reply brief, filed by taxpayer. 3/23/55—Granted.
- Apr. 4—Reply Brief filed by taxpayer. Copy served.
- Aug. 23—Findings of Fact and Opinion filed. Judge Raum, Decision will be entered for the respondent. Copy served.
- Aug. 24—Decision entered, Judge Raum, Div. 11.
- Nov. 17—Petition for Review by U. S. Court of Appeals for the Ninth Circuit, filed by petitioner.
- Nov. 21—Proof of Service filed.
- Dec. 6—Statement of Points with acknowledgment of service thereon filed by petitioner.
- Dec. 6—Designation of Contents of Record with acknowledgment of service thereon, filed by petitioner.
- Dec. 7—Designation of Additional Portions of Record with statement of service by mail thereon, filed by respondent.
- Dec. 20—Order extending time to Feb. 15, 1956, for filing the record and docketing the appeal, entered.

## The Tax Court of the United States

Docket No. 28582

Estate of HERBERT B. MILLER, Deceased, THE UNITED STATES NATIONAL BANK OF PORTLAND (Oregon), Former Executor of Said Estate, Executor of Said Estate, Administrator De Bonis Non with Will Annexed of Said Estate, as Distributee-Trustee of Said Estate, and Individually,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

## SECOND AMENDED PETITION

The above named petitioner, leave of Court having been first obtained, hereby files its Second Amended Petition, and hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Seattle IT:90D:HWF), dated February 28, 1950, and as a basis of its proceedings, alleges as follows:

## I.

Herbert B. Miller died testate on February 13, 1948. The United States National Bank of Portland (Oregon), was appointed Executor of the estate of said decedent on February 17, 1948. On or about May 21, 1949, The United States National

Bank of Portland (Oregon), filed with the Commissioner of Internal Revenue formal notice of its fiduciary capacity for petitioner-taxpayer pursuant to the Internal Revenue Code, Section 312(a). On or about July 14, 1949, the administration of the estate was completed and the United States National Bank of Portland (Oregon) was discharged as Executor. The United States National Bank of Portland (Oregon), did not give the Commissioner of Internal Revenue formal notice of the termination of its fiduciary capacity pursuant to Section 312(b), of the Internal Revenue Code. That at all times and dates herein mentioned The United States National Bank of Portland (Oregon), was and now is the duly appointed, qualified and acting Executor of said estate, and has been and is now acting in a fiduciary capacity with respect to said estate, assuming all of the powers, rights, duties and privileges of said petitioner-taxpayer with respect to the taxes imposed by the Internal Revenue Code, or within the meaning of Section 312 of the Internal Revenue Code. On or about July 14, 1949, the entire residuary estate subject to minor specific bequests, was distributed under the terms of the Last Will and Testament of said decedent to The United States National Bank of Portland (Oregon), as trustee under the Last Will and Testament of said decedent. Petitioner is still acting as such trustee and is in possession of the residuary assets of decedent's estate. On October 9, 1950, the Circuit Court of the State of Oregon for the County of Multnomah, Department of Probate, reopened said

estate and the petitioner was duly appointed administrator de bonis non with will annexed of decedent's estate. The return of the calendar year 1946 was filed with the Collector of Internal Revenue at Portland, Oregon.

## II.

The notice of deficiency, a copy of which is attached and made a part of this petition by reference, is dated February 28, 1950.

## III.

The tax in controversy is income tax for the calendar year 1946 for which a deficiency of \$1,882.27 is asserted.

## IV.

The determination of tax set forth in the said notice of deficiency is based upon the following errors: 1. The Commissioner of Internal Revenue erred in determining an increase in dividend income of \$5,105.74.

2. The Commissioner of Internal Revenue erred in determining a decrease to capital gains for the calendar year 1946 in the amount of \$3,984.17.

## V.

The facts upon which the petitioner relies as a basis of this proceedings are as follows:

1. Miller Paint Co., Inc., was duly organized and incorporated under the laws of the State of Oregon in May, 1946.

2. The facts and circumstances leading up to the decision to organize Miller Paint Co., Inc., were as follows:

(a) A desire to form a business entity to assure the continuity of the business upon the death of one of the partners whose decease was imminent due to advanced cancer.

(b) To remove from the paint business a portion of the assets of the two partners who had no issue so as to permit the division among the employees of the paint business upon the death of said partners without disturbing the continuity of management and without bequeathing the entire estate to such employees.

(c) To take out of and set aside from the interest of the partner whose death was imminent, a portion of the net value of the paint business.

(d) To simplify the administration of the estate of any partner.

3. All of the authorized capital stock of the said corporation was subscribed for and paid for in cash.

4. In June, 1946, Miller Paint Co., Inc., acting through its directors, purchased certain assets from the deceased taxpayer and others and tendered short term notes in payment thereof. Said notes were ac-

5. The purchase made by the said corporation cepted by deceased taxpayer and others.

was on the basis of fair market value at the time of the purchase.

6. The gain realized by the deceased taxpayer on the said sale was reported by him as a long-term capital gain.

7. No securities were ever issued by the corporation other than the original capital stock which was paid for in cash.

8. The payments claimed by the Commissioner to be dividend income were payments made upon interest and principal of said notes.

9. No dividend had been declared by the directors of Miller Paint Co., Inc., prior to the payments designated by the Commissioner as dividend income.

10. The purchase of the said assets by Miller Paint Co., Inc., was a sound and reasonable business transaction and the payment of the notes used therein was reasonable and necessary.

11. The said notes were legal obligations of Miller Paint Co., Inc., and enforceable by appropriate legal action.

12. The notes received by the deceased taxpayer were included in his federal estate tax return as notes receivable.

Wherefore, the petitioner prays that this Court may hear the proceeding and:

(1) Determine that the Commissioner erred in increasing dividend income in the amount of \$5,105.74.

(2) Determine that the Commissioner erred in decreasing capital gains in the amount of \$3,984.17.

(3) Grant such other and further relief as the Court may deem proper.

/s/ CHESTER E. McCARTY,  
Attorney for Petitioner.

Form 1230

Treasury Department  
Internal Revenue Service

Securities Building  
Seattle 1, Washington  
February 28, 1950

Office of  
Internal Revenue Agent in Charge  
Seattle Division  
IT:90D:HWF

Estate of Herbert B. Miller, Deceased,  
United States National Bank of Portland (Oregon),  
Former Executor, Portland, Oregon.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1946, discloses a deficiency of \$1,882.27 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at its principal address, Washington 24, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Seattle 1, Washington, for the attention of IT:90D:HWF. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, which ever is earlier.

Very truly yours,

GEO. J. SCHOENEMAN,  
Commissioner,

By S. R. STOCKTON,  
Internal Revenue Agent  
in Charge.

Enclosures:

Statement

Form 1276

Form of waiver

HWF:mtr



IT :90D :HWF

Statement

Estate of Herbert B. Miller, Deceased  
 United States National Bank of Portland, (Oregon)  
 Former Executor  
 Portland, Oregon

Tax Liability for the Taxable Year Ended December 31, 1946

	Deficiency
Income Tax .....	\$ 1,882.27

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated June 30, 1949, and to your protest dated September 16, 1949.

Adjustments to Net Income

Net income as disclosed by return .....	\$39,170.25
Unallowable deductions and additional income:	
(a) Dividends increased .....	\$ 5,105.74
(b) Partnership income increased ..	1,231.18
(c) Taxes reduced .....	23.37
	6,360.29
	\$45,530.54
Nontaxable income and additional deductions:	
(d) Capital gain reduced .....	3,984.17
	\$41,546.37
Net income adjusted .....	

Explanation of Adjustments

(a) It has been determined that the \$7,500.00 which the decedent received from Miller Paint Co., Inc., and excluded from gross income included a taxable distribution in the amount of \$5,105.74. Net income is increased accordingly.

(b) It has been determined that the decedent's distributable portion of the ordinary net income of Miller Paint Co., a partnership, was \$20,018.02, an increase of \$1,231.18 over the amount of such income reported.

(c) The telephone tax in the amount of \$23.37 claimed on the return is not an allowable deduction within the purview of Section 23(c) of the Internal Revenue Code.

(d) It has been determined that no gain or loss should be recognized upon the transfer of the net assets of the partnership, Miller Paint Co., to the corporation, Miller Paint Co., Inc. Therefore, the long-term capital gain reported by the decedent on the transfer of his proportionate share of such assets is eliminated from income.

Computation of Tax

Net income amended .....	\$41,546.37
Less: Exemptions .....	1,500.00
	-----
Normal tax and surtax net income .....	\$40,046.37
Tentative normal tax and surtax .....	\$19,772.00
Less: 5% of tentative tax .....	988.60
	-----
Income tax liability .....	\$18,783.40
Previous assessment	
Account No. 3013011 .....	16,901.13
	-----
Deficiency in income tax .....	\$ 1,882.27

Duly verified.

Lodged December 5, 1950.

Filed December 5, 1950, T.C.U.S.

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[Title of Tax Court and Cause.]

**ANSWER TO SECOND AMENDED PETITION**

Comes Now the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the second amended petition herein, admits and denies as follows:

1. Admits the allegations contained in paragraph I of the second amended petition.

2. Admits the allegations contained in paragraph II of the second amended petition.

3. Admits the allegations contained in paragraph III of the second amended petition.

4. Denies that he erred in his determination of deficiency in income tax as shown by the notice of deficiency from which petitioner's appeal is taken. Specifically denies that he erred in the manner and form as alleged in paragraph IV(1) and (2) of the second amended petition.

5(a). Admits that Miller Paint Co., Inc., was duly organized and incorporated under the laws of the State of Oregon. For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining allegations contained in paragraph V(1) of the second amended petition.

(b) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph V(2)(a), (b), (c) and (d) of the second amended petition.

(c) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph V(3), (4) and (5) of the second amended petition.

(d) Admits that the deceased taxpayer reported certain income as a long-term capital gain. For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining allegations contained in paragraph V(6) of the second amended petition.

(e) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph V(7) of the second amended petition.

(f) Denies the allegations contained in paragraph V(8) of the second amended petition.

(g) For lack of sufficient knowledge or information upon the basis of which to form a belief as to the truth or falsity thereof, denies the allegations contained in paragraph V(9), (10), (11) and (12) of the second amended petition.

6. Denies generally and specifically each and every material allegation contained in the second amended petition, not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that petitioner's appeal be denied and that the Commissioner's determination of deficiency be approved.

/s/ CHARLES OLIPHANT,  
Chief Counsel,  
Bureau of Internal Revenue

Of Counsel:

WILFORD H. PAYNE,  
Division Counsel;

JOHN H. PIGG,  
Special Attorney,  
Bureau of Internal Revenue

Received and filed December 28, 1950, T.C.U.S.

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[Title of Tax Court and Cause.]

Docket Nos. 28582 and 31063

### STIPULATION OF FACTS

It is hereby stipulated and agreed between the Commissioner of Internal Revenue and the above entitled taxpayer, by their respective undersigned attorneys, that the following facts shall be taken as true, provided, however, that this stipulation does not waive the right of either party to introduce other evidence not at variance with the facts herein stipulated, or to object to the introduction in evidence of any such facts on the ground of immateriality or irrelevancy.

1. Herbert B. Miller died testate on February 13, 1948. The United States National Bank of Portland (Oregon), was appointed Executor of the estate of said decedent on February 17, 1948. On or about May 21, 1949, The United States National Bank of Portland (Oregon), filed with the Commissioner of Internal Revenue formal notice of its fiduciary capacity for petitioner-taxpayer pursuant

to the Internal Revenue Code, Section 312(a). On or about July 14, 1949, the administration of the estate was completed and The United States National Bank of Portland (Oregon), was discharged as Executor. The United States National Bank of Portland (Oregon), did not give the Commissioner of Internal Revenue formal notice of the termination of its fiduciary capacity pursuant to Section 312(b), of the Internal Revenue Code. At all times and dates herein mentioned The United States National Bank of Portland (Oregon), was and now is the duly appointed, qualified and acting Executor of said estate, and has been and is now acting in a fiduciary capacity with respect to said estate, assuming all of the powers, rights, duties and privileges of said petitioner-taxpayer with respect to the taxes imposed by the Internal Revenue Code, or within the meaning of Section 312 of the Internal Revenue Code. On or about July 14, 1949, the entire residuary estate subject to minor specific bequests, was distributed under the terms of the Last Will and Testament of said decedent to The United States National Bank of Portland (Oregon) as trustee under the Last Will and Testament of said decedent. Petitioner is still acting as such trustee and is in possession of the residuary assets of decedent's estate. On October 9, 1950, the Circuit Court of the State of Oregon for the County of Multnomah, Department of Probate, reopened said estate and the petitioner was duly appointed administrator de bonis non with will annexed of decedent's estate. The return of the calendar year 1946 was filed with

the Collector of Internal Revenue at Portland, Oregon.

2. The notices of deficiency from which the respective appeals herein are taken, copies of which are attached to the respective petitions and each marked Exhibit "A" were mailed to petitioner on February 28, 1950, and August 7, 1950. The taxes in controversy are income taxes of Herbert B. Miller for the taxable years 1946 and 1947 in the respective amounts of \$1,882.27 and \$3,982.35.

3. Prior to June 1, 1946, the decedent, Herbert B. Miller, and his brothers, Walter M. Miller and Ernest Miller, Jr., were associated together in a partnership doing business under the assumed name of Miller Paint Co. in Portland, Oregon. The assets of this partnership consisted only of cash and items of personal property. Certain real estate used by the partnership was rented from Miller Paint and Wallpaper Co., a co-partnership composed of the same three individuals.

4. The following described photostatic copies of tax returns may be offered and received in evidence in lieu of the originals, and may be identified as follows:

Return

Exhibit

1-A—Partnership Return, form 1065, Miller Paint Co., Portland, Oregon, January 1, 1946, to May 31, 1946.

- 2-B—1946 Individual income tax return, form 1040, Herbert B. Miller.
- 3-C—1947 Individual Income Tax Return, form 1040, Herbert B. Miller.
- 4-D—Corporation Income Tax Return, form 1120, taxable period ended November 30, 1946, Miller Paint Co., Inc., Portland, Oregon.
- 5-E—Corporation Income Tax Return, form 1120, taxable period ended November 30, 1947, Miller Paint Co., Inc., Portland, Oregon.
- 6-F—Federal Estate Tax Return, form 706, Estate of Herbert B. Miller, Deceased, certain excerpted schedules only.

5. A photostatic copy of a protective claim for refund of estate taxes filed by the Estate of Herbert B. Miller, deceased, may be admitted in evidence solely for the purpose of advising the Court with respect to the adjustments made by respondent and objected to by petitioner, and the same, or the facts stated therein shall not be regarded as proof of any fact alleged in the claim or an admission on the part of the petitioner. This document may be identified as Exhibit 7-G.

6. Photostatic copies of the statutory notice of deficiency and thirty-day notice of a proposed deficiency issued by respondent with respect to the income tax liability of Miller Paint Co., Inc., may be admitted in evidence solely for the purpose of advising the Court as to the respondent's adjustments to the income and available earnings and profits of the corporation made by the respondent for the tax-



able periods ended November 30, 1946, and November 30, 1947, respectively. These documents may be admitted and identified as Exhibits H and I.

7. A photostatic copy of the report of examination of the income of Miller Paint Co., a co-partnership, may be admitted in evidence as 8-J solely for the purpose of advising the Court with respect to an adjustment to income of petitioner for the taxable year 1946.

8. The above named partners, Herbert B. Miller, Walter M. Miller and Ernest Miller, Jr., on or about May 13, 1946, formed an Oregon Corporation known as Miller Paint Co., Inc., sometimes referred to herein as the corporation. The authorized capital stock of 300 shares no par value was subscribed for at the basis of \$3.50 per share and in equal portions by the three partners. The amounts subscribed were paid for in cash from their personal bank accounts, on or about August 2, 1946, as shown in Exhibit 9-K, a photostatic copy of a composite Exhibit consisting of a check of Walter Miller, a Miller Paint Co., Inc., bank statement and a Miller Paint Co., Inc., duplicate deposit slip.

9. The corporation received its charter on May 18, 1946. The stock was issued on May 20, 1946, and the corporation was ready to begin business on June 1, 1946.

10. The corporation acquired a large portion of the assets of the partnership. It succeeded to the business of the Miller Paint Co. partnership. All the

tangible assets, including inventory, equipment and fixtures of the partnership were acquired by the corporation. The agreed fair market value of the various physical assets acquired on June 1, 1946, was as follows:

	Fair Market Value June 1, 1946
Inventory .....	\$60,122.49
Machinery and Equipment .....	15,000.00
Furniture and Fixtures .....	3,000.00
Delivery Equipment .....	7,500.00
Office Equipment .....	1,000.00
	<hr/>
Total .....	\$86,622.49

The adjusted basis of the same assets in the partnership as of May 31, 1946, was lower.

11. The Corporation also acquired from the partnership their accounts receivable, petty cash and change fund, and some unearned insurance premiums and assumed certain trade accounts payable of the partnership, as follows:

Petty Cash and Change Fund .....	\$ 598.00
Accounts Receivable .....	89,328.54
Unexpired Insurance .....	636.40
	<hr/>
Total .....	\$90,562.94
Less: Accounts Payable .....	52,614.17
	<hr/>
Balance .....	\$37,948.77

12. Decedent, Herbert B. Miller, received the amounts of \$7,500 and \$10,000 from Miller Paint

Co., Inc., during the respective taxable period ended November 30, 1946, and November 30, 1947. Equal amounts were paid to Walter M. Miller and Ernest Miller, Jr. The item of "Notes Payable" on the Balance Sheet of the corporation of \$174,571.26 was reduced in amounts the equivalent of the foregoing payments to the respective shareholders.

13. Respondent contrary to petitioner's contentions determined that there were available for distribution earnings and profits of Miller Paint Co., Inc., in the amounts of \$15,317.23 and \$29,062.09 during the respective taxable periods ended November 30, 1946, and November 30, 1947, and that the above described payments of \$7,500 and \$10,000 to each of the shareholders as aforesaid represented distributions to that extent. The following computation shows the method respondent used in arriving at these amounts:

	Taxable Period Ended	
	Nov. 30, 1946	Nov. 30, 1947
Net income per return .....	\$22,024.24	\$48,448.19
Adjustments to income, per statutory notice .....	3,881.29	15,571.40
Corrected net income .....	\$25,905.53	\$64,019.59
Income tax liability .....	6,224.02	24,203.94
Available for distribution .....	\$19,681.51	\$39,815.65
Disallowed interest deduction .....	(4,364.28)	(7,603.56)
Excessive Salary .....		(3,150.00)
Remainder treated as taxable dividends by respondent .....	\$15,317.23	\$29,062.09

14. Joint Exhibit 10-L, a photostatic copy of the earning and asset schedule of Miller Paint Co., a co-partnership, and Miller Paint Co., Inc., may be admitted to show the data behind the appraisement of the Miller Paint Co., Inc., stock owned by Herbert B. Miller as of the date of death. The following computation shows the method the Executor used in arriving at the appraised value of the stock:

$$\frac{\text{Average Net Income X 5} = \text{Fair Market Value of 1 Share}}{300 \text{ Shares}}$$

$$\$20,866.76 \text{ X } 5 = \quad \quad \quad \$347.78$$

15. The following described photostatic copies of documents may be offered and received in evidence in lieu of the originals and may be identified as follows:

#### Document

#### Exhibit

- 11—Composite document of letter of the U.S. National Bank directed to Miller Paint Co., Inc., dated January 10, 1951 with enclosure.
- 12—Death certificate of Herbert B. Miller.
- 13—Chattel mortgage Miller Paint Co., Inc., to Ernest Miller, Jr., Herbert B. Miller, and Walter B. Miller dated June 3, 1946.
- 14—Certified copy of Inventory and Appraisement filed in the estate of Herbert B. Miller, deceased, in the Circuit Court of the State of Oregon for the County of Multnomah, Department of Probate, proceeding No. 59444.

15—Certified copy of Last Will and Testament of Herbert B. Miller.

16. A duplicate original of letter from Pattullo and Wilson to Chester E. McCarty dated June 23, 1946, may be admitted in evidence for the purpose of advising the Court of the instructions to the corporation through their attorney relative to the entries and the beginning balance sheet of the corporation.

17. Photostatic copies in lieu of the originals may be introduced of the following documents subject to further identification by petitioner's witnesses.

#### Document

#### Exhibit

17—Composite exhibit of notes payable by Miller Paint Co., Inc., to Ernest Miller, Jr., Herbert B. Miller, and Walter M. Miller.

18—Note payable by Miller Paint Co., Inc., to Herbert B. Miller dated June 1, 1946, in sum of \$28,874.16.

19—Note payable by Miller Paint Co., Inc., to Herbert B. Miller dated June 1, 1946, in sum of \$29,316.26.

20—Thirty day letter directed to Mrs. Blanche M. Miller for year 1949.

21—Ninety day letter directed to Mrs. Blanche M. Miller for year 1949.

22—Thirty day letter directed to testamentary trust of Herbert B. Miller for year 1949.

23—Ninety day letter directed to testamentary trust of Herbert B. Miller for year 1949.

24—Photostatic copy of interoffice communication of U.S. National Bank re Miller Paint Co., partnership.

25—Extract of minutes of Miller Paint Co., Inc.

18. Respondent reserves the right to cross-examine any of petitioner's witnesses with respect to any facts or documents herein stipulated.

/s/ DANIEL A. TAYLOR, JHP  
Chief Counsel Internal Revenue Service, Counsel  
for Respondent.

/s/ GEORGE W. MILLER,  
Of Counsel for Petitioner.

Filed at hearing October 11, 1954.

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The Tax Court of the United States

Docket Nos. 28582, 31063

#### FINDINGS OF FACT AND OPINION

Three equal partners determined to operate their business in corporate form. Pursuant to a pre-arranged plan they paid a nominal amount for all the stock, which was no par and of a nominal declared value, of a newly organized corporation, and thereafter transferred to it substantially all the operating assets of the partnership plus \$50,000 in cash. The corporation issued notes purportedly in exchange for such assets and cash. Held, the sum representing the declared value of the stock was grossly inadequate to operate the business and the low stated value was a fiction; the risk capital ac-

tually contributed to the corporation was represented by the operating assets and cash; no bona fide indebtedness was created by the notes; and the true consideration for the cash and operating assets was the stock alone. Payments which the corporation subsequently made purportedly with respect to the notes constituted in fact distributions of taxable dividends to the extent of available earnings and profits, Section 115(a), I.R.C. 1939.

Held further, the above transactions constituted a transfer within Section 112(b)(5), I.R.C. 1939. No gain was recognized to the transferors, and the basis to the transferee corporation of the assets received by it is the same as that in the hands of the transferors immediately prior to the exchange, Section 113(a)(8), I.R.C. 1939.

GEORGE W. MILLER, ESQ., and  
DAVID S. PATTULLO, ESQ.,

For the Petitioner.

JOHN H. WELCH, ESQ.,

For the Respondent.

The respondent determined deficiencies in the income tax of Herbert B. Miller for 1946 and 1947 in the amounts of \$1,882.27 and \$3,982.35, respectively. The issues are, first, whether certain corporate distributions constituted taxable dividends, and, second, whether the purported sale of various assets to a corporation together with a contribution of cash constituted in reality a transfer governed by the non-recognition provisions of Section 112(b)(5) and the basis provisions of Section 113(a)(8) of the Internal Revenue Code of 1939.

## Findings of Fact

Some of the facts have been stipulated by the parties. Such facts are incorporated herein by this reference as part of our findings.

Herbert B. Miller (hereinafter sometimes called "decedent") died on February 13, 1948, a resident of Milwaukie, Orgeon. His individual income tax returns for the calendar years 1946 and 1947 were filed on the cash basis with the collector of internal revenue for the district of Oregon at Portland, Oregon.

The United States National Bank of Portland (hereinafter called "petitioner") was duly appointed as executor of decedent's will. Pursuant to the will, the decedent's entire residuary estate, after minor specific bequests, was distributed to petitioner as trustee. Petitioner is still trustee and in possession of the estate. On October 9, 1950, the Circuit Court of the State of Oregon for the County of Multnomah reopened the estate, and petitioner was duly appointed administrator de bonis non, cum testamento annexo. At the time of the trial of this case petitioner was still acting in its capacity as such administrator.

Prior to June 1, 1946, decedent and his two brothers, Ernest Miller, Jr., (hereinafter sometimes called "Ernest") and Walter M. Miller (hereinafter sometimes called "Walter"), were equal partners in the paint manufacturing and marketing business in Portland, Oregon, doing business as Miller Paint



Co. (hereinafter sometimes called the "firm"). The assets of the firm consisted of personal property, accounts receivable and cash. The real estate occupied by the firm was rented from Miller Paint and Wallpaper Co., another copartnership composed of the same three persons.

Blanche M. Miller is the widow of the decedent. Sometime in 1943 or 1944 she was informed by a physician that her husband had cancer, and could live only a few years longer. Ernest and Walter were informed of this, but none of them told the decedent, and it is not apparent whether he ever became aware of his condition.

Ernest and Walter became concerned over the problem of continuity of the business in case of the death or incapacity of a partner. Without revealing anything to the decedent relative to his physical condition, they convinced him that some steps should be taken to insure such continuity.

Decedent was the only partner with children. Ernest was married but had no children, while Walter was unmarried. The three brothers desired an arrangement whereby death or incapacity of a partner would not affect the continuity of the business, the business could carry on free of interference in case of possible complications in the eventual probate of an estate, and an estate could be created for the benefit of a decedent's family in case of his death. In addition, Ernest wished to leave his share of the business to some employees without disturbing management and control.

In late 1945 the partners conferred with trust officers of the petitioner as to the best method to accomplish the ends sought, and were advised that a trust could be created. Independent counsel, however, was also consulted, and advised that the corporate form would best serve their purposes. They decided to form a corporation and transfer to it assets necessary to carry on the business, but to take the cash of the firm into their hands individually. In the years immediately prior to June 1, 1946, earnings had been high, and no evidence was presented suggesting any doubts at that time that the prosperous condition of the business would continue.

In accordance with the plan to incorporate the business, Miller Paint Co., Inc. (hereinafter called the "corporation") was organized pursuant to the laws of the State of Oregon on or about May 13, 1946. The charter was received on May 18, 1946. Total authorized capital consisted of 300 shares of no par stock. Each partner subscribed for 100 shares of no par stock. Each partner subscribed for 100 shares at a stated value of \$3.50 per share. The shares were issued on May 20, 1946. Oregon law requires that a corporation with no par stock have a capital investment of at least \$1,000. Each partner paid the stated value of the stock subscribed for by him in cash from his respective personal bank account.

The first meeting of the board of directors was held on May 20, 1946. It was resolved that the cor-

poration borrow \$50,000 from the three partners and execute a three-year promissory note therefor bearing interest at five per cent per annum. This resolution was carried out on June 1, 1946. At another meeting, held on June 3, 1946, it was resolved that the corporation purchase from the partners at inventory value substantially all the operating assets of the firm. The fair market value of such assets was \$86,622.49, and a note in such amount was issued, payable in annual installments of no less than \$20,000, and bearing interest at five per cent per annum.

Another resolution called for the purchase by the corporation of certain intangible assets of the firm, subject to liabilities. The net fair market value thereof was \$37,948.77, and a note in that amount was given to the partners. The note bore interest at five per cent per annum and was payable six years from date.

Each of the foregoing notes was issued to the partners in their joint names. The partners at all times considered their interests in the assets and in the notes received therefor to be equal.

The corporation executed and delivered a chattel mortgage encumbering its personal property as security for the notes in the amounts of \$86,622.49 and \$37,948.77, which had been issued in exchange for the tangible and intangible assets, respectively, of the firm.

As a result of the foregoing, the corporation acquired a substantial amount of cash and the business assets of the firm, and succeeded to the latter's business. The tangible assets so acquired were as follows:

Item	Fair Market Value on June 1, 1946
Inventory .....	\$60,122.49
Machinery and Equipment.....	15,000.00
Furniture and Fixtures.....	3,000.00
Delivery Equipment .....	7,500.00
Office Equipment .....	1,000.00
Total .....	<u>\$86,622.49</u>

The adjusted basis of the firm in the above assets on June 1, 1946, was less than the fair market value thereof. The firm reported a gain in the amount of \$6,683.68, which was proportionally reflected and reported as a long-term capital gain on the individual income tax returns of the partners.

Other assets of a net fair market value of \$37,948.77 acquired by the corporation were as follows:

Item	Amount
Petty cash and change fund.....	\$ 598.00
Accounts Receivable .....	89,328.54
Unexpired Insurance .....	636.40
Total .....	<u>\$90,562.94</u>
Less: Accounts Payable .....	52,614.17
Balance .....	<u>\$37,948.77</u>

At a meeting of the board of directors on July 31, 1946, it was resolved that the foregoing three notes be cancelled, and that in lieu thereof new notes be issued separately to each partner in the amount of his one-third interest.

Pursuant to the above resolution, the notes for \$50,000 and \$37,948.77 were cancelled, and a note in the face amount of \$29,316.26 was issued to each partner. At the same time the note for \$86,622.49 was cancelled and each partner received a note for \$28,874.16. Of the new notes issued, the latter were payable in annual installments of no less than \$6,666.66, while the former were payable six years from date. All bore interest at five per cent per annum. By resolution of the board of directors, the previously executed chattel mortgages were made to stand as security for the payment of the new notes. The books of the corporation have at all times carried the amounts of these notes as a "Notes Payable" liability.

In 1946 and 1947 decedent received amounts designated as payments upon the principal of the note held by him in the face amount of \$28,874.16. These payments amounted to \$7,500 in 1946 and \$10,000 in 1947. Equal amounts were paid to Ernest and Walter on their respective notes, and a corresponding reduction in the "Notes Payable" account was taken on the books of the corporation. No dividend has ever been formally declared by the corporation despite substantial earnings.

The principal purpose in forming the corporation was to transfer to it the business conducted up to that time by the firm together with a substantial amount of cash. No material change in the investment of the partners was contemplated, except that they would now be carrying on the same business in corporate form.

The initial creation of the corporation with stock of a declared value of \$1,050 was viewed by the partners as merely the first step in a single plan, the over-all objective whereof was to transfer the paint business to the corporation so that they could continue to operate the business in a new form. The several transfers set forth above, though occurring on different days, were in fact parts of a single integrated transaction.

The cash and all other assets transferred to the corporation in May and June of 1946, were intended by the partners as a permanent investment. There was no bona fide intention to effect a sale or dispose of the business in any other manner. The total cash and total value of assets transferred to the corporation is the true measure of the capital investment of the partners in the corporation, and was the actual consideration paid for the stock in substance, though not in form. The notes did not create a bona fide debtor-creditor relationship. No business reason dictated the formal method of capitalization undertaken. The payments at issue were received by decedent as a stockholder, not as a

creditor, and constituted taxable dividends to the extent of available earnings and profits.

The foregoing transaction was in substance a transfer of property solely in exchange for stock of the transferee corporation, and is governed by the provisions of Section 112(b)(5) of the Internal Revenue Code of 1939. No gain was recognizable to the transferors and the basis to the corporation is the same as that in the hands of the transferors prior to the exchange, pursuant to Section 113(a)(8) of the Internal Revenue Code of 1939.

### Opinion

Raum, Judge:

While two issues have been separately stated, they are actually different aspects of the same question. Both depend upon the reality of the purported indebtedness evidenced by the notes.

It should be noted at the outset that this is not a case involving "hybrid securities," a term generally used to describe corporate instruments bearing indicia both of evidence of indebtedness and of capital investment, where the problem is one of determining whether the terms of the instrument as read create an effect more like that of an investment or more like that of a debt. See, e.g., *Universal Oil Products Co. v. Campbell*, 181 F. 2d 451, 476-477 (C.A. 7), certiorari denied, 340 U.S. 850; *Commissioner v. J. N. Bray Co.*, 126 F. 2d 612 (C.A. 5); *Commissioner v. Palmer, Stacey-Merrill, Inc.*, 111 F. 2d 809 (C.A. 9); *Commissioner v. Proctor Shop*,

82 F. 2d 792 (C.A. 9); Mullin Building Corporation, 9 T.C. 350, affirmed per curiam, 167 F. 2d 1001 (C.A. 3); Charles L. Huisking & Co., Inc., 4 T.C. 595.

The form of the notes in the instant case presents no such problem. These notes, standing by themselves, are clear evidences of indebtedness. As we understand respondent's position, it is that there was no genuine indebtedness underlying the notes, that the consideration purportedly given for the notes was in fact the true risk capital of the corporation and must be treated as reflected in the stock rather than the notes which must be disregarded. In short, it is another way of saying that substance must prevail over form, and the substance of the transaction at issue was that of a capital investment for stock and not a sale for notes. Our analysis of the facts forces us to agree with the conclusions of the respondent.

The form of a transaction has some evidentiary value, but it is not conclusive. *Gregory v. Helvering*, 293 U.S. 465. The same is true of bookkeeping entries. *Doyle v. Mitchell Brothers Co.*, 247 U.S. 179. The crucial factor here is not the formal characterization of these notes, but, rather, the proper characterization of the underlying transaction and the relationship in fact created thereby. Cf. *Gooding Amusement Co.*, 23 T.C. 408, on appeal (C.A. 6); *Kraft Foods Co.*, 21 T.C. 513, on appeal (C.A. 2); *1432 Broadway Corporation*, 4 T.C. 1158,



affirmed per curiam, 160 F. 2d 885 (C.A. 2). In *Kraft Foods Co.*, supra, we said (21 T.C. at p. 594):

\* \* \* we do not have here a case in which the instruments involved had some of the characteristics of both debentures and certificates of stock \* \* \*. In the instant case, all of the requirements of form and ritual necessary to make the instruments debentures were meticulously met. They were either evidences of indebtedness and effective as such, or, being purely ritualistic and without substance, were futile and ineffective to make the annual payments interest.

The intention of the parties is controlling, and such intention is a fact to be gleaned from the entire record. Cf. *Tribune Publishing Company*, 17 T.C. 1228; *Ruspyn Corporation*, 18 T.C. 769; *Isidor Dobkin*, 15 T. C. 31, affirmed per curiam, 192 F. 2d 392 (C.A. 2); *Lansing Community Hotel Corporation*, 14 T. C. 183, affirmed per curiam, 187 F. 2d 487 (C.A. 6); *Sam Schnitzer*, 13 T.C. 43, affirmed per curiam, 183 F. 2d 70 (C.A. 9), certiorari denied, 340 U.S. 911; *Cleveland Adolph Mayer Realty Corporation*, 6 T.C. 730, reversed on another issue, 160 F. 2d 1012 (C.A. 6); *Joseph B. Thomas*, 2 T.C. 193.

In *United States v. Title Guarantee & Trust Co.*, 133 F. 2d 990 (C.A. 6), where it was held that under the facts of that case the intention of the parties was to create a true debtor-creditor relationship, the Court said at p. 993:

The essential difference between a stockholder and a creditor is that the stockholder's intention is to embark upon the corporate adventure, taking the risks of loss attendant upon it, so that he may enjoy the chances of profit. The creditor, on the other hand, does not intend to take such risks so far as they may be avoided, but merely to lend his capital to others who do intend to take them. \* \* \* (Italics in original.)

Applying the foregoing criteria to the facts before us, we must conclude that we have here no bona fide intention to effect a true debtor-creditor relationship. The partners at all times intended to be investors in the corporate business, as they had been in the firm business, to the full extent of all value contributed by them. The cash and other property transferred to the corporation was deemed by them and was in fact necessary for the successful operation of that business. Cf. Hilbert H. Bair, 16 T.C. 90, affirmed, 199 F. 2d 589 (C.A. 2). The contributions which petitioner contends created an indebtedness constituted substantially everything the corporation owned<sup>1</sup> and which it

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<sup>1</sup>In form, the \$50,000 cash appeared to come from the partners personally. However, the evidence discloses that the partnership had a substantial amount of cash and that such cash was taken out by the partners prior to the transfer of partnership assets to the corporation. It seems quite clear that the \$50,000 cash represented in substance that portion of the partnership cash that the partners regarded as necessary to operate the business.

required in order to commence doing business and to remain in business. It was at all times intended that the value of such contributions should remain indefinitely at the risk of the going business as part of its permanent capital structure. To be sure, the partners undoubtedly expected, as contended by petitioner, earnings to be sufficiently high that in a relatively short time they would be able to withdraw sums approximating in amount their original capital investment without impairing necessary capital; and subsequent events seem to prove this expectation to have been justified. This, however, does not alter the fact that everything transferred to the corporation in May and June of 1946 was intended to remain therein as part of its permanent capital structure; only surplus earnings, to be subsequently acquired as a result of successful operations of the business were in fact intended to be withdrawn. Cf. Gregg Co. of Delaware, 23 T.C. 170, on appeal (C.A. 2). Indeed, petitioner's contention proves too much. It demonstrates plainly to us that the partners intended to use the notes as a device to siphon subsequent earnings from the enterprise while leaving the basic business assets with the corporation. Purported payments upon the notes in such circumstances would be in substance nothing more than the distribution of dividends to the stockholders, who held the notes in the same proportion as their stockholdings.

Although the notes in form are absolute, and call for fixed payments, we have no doubt, from a read-

ing of the entire record, that no payment was ever intended or would ever be made or demanded which would in any way weaken or undermine the business. As we said in *Gooding Amusement Co.*, supra, 23 T.C. at p. 418:

There is nothing reprehensible in casting one's transactions in such a fashion as to produce the least tax \* \* \*. On the other hand, tax avoidance will not be permitted if the transaction or relationship on which such avoidance depends is a "sham" or lacks genuineness. The concept that substance shall prevail over form has likewise been enunciated in numerous cases. \* \* \*

In the instant case, in the matter of form, the notes in question present no problem of interpretation. The formal criteria of indebtedness are unquestionably satisfied. The notes on their face are unconditional promises to pay at a fixed maturity date a sum certain and the payment of interest thereon is not left to anyone's discretion. The instruments in form are pure evidences of indebtedness.

But we are not limited in our inquiry to the instruments themselves. We may look at all the surrounding circumstances to determine whether the real intention of the parties is consistent with the purport of the instrument. \* \* \*

The most significant aspect of the instant case, in our view, is the complete identity of

interest between and among the three note holders, coupled with their control of the corporation \* \* \*. It is \* \* \* unreasonable to ascribe to the husband petitioner \* \* \* an intention at the time of the issuance of the notes ever to enforce payment of his notes, especially if to do so would either impair the credit rating of the corporation, cause it to borrow from other sources the funds necessary to meet the payments, or bring about its dissolution \* \* \*

In *Mullin Building Corporation*, supra, we said (9 T.C. at p. 355):

If the debenture stockholders are entitled to enforce payment \* \* \* upon default \* \* \* and should do so, petitioner's only income-producing asset \* \* \* would either have to be liquidated or encumbered \* \* \*. If the [asset] should be liquidated, the flow of \* \* \* income therefrom would cease; or, if the [asset] should be mortgaged \* \* \* petitioner would pay out a large part of its earnings in interest and for retirement of principal to its mortgage creditor \* \* \*. Such a course would be too irrational \* \* \* to merit \* \* \* contemplation \* \* \*. Such a course is not within the realm of sane business practice and we are convinced that it was not intended.

Similarly, in the case at bar, in the light of all the surrounding facts and circumstances, it is not reasonable to accept the absoluteness in form of

the notes at face value. To do so would be to impute a willingness on the part of the partners to endanger their chief source of livelihood.

And see 1432 Broadway Corporation, *supra*, where we said (4 T.C. at p. 1164):

\* \* \* The debentures are in approved legal form, and, if their legal attributes alone were determinative of the character of the interest accruals, there would be little room for doubt that they were the indebtedness they purport to be. [Citing.] But, for tax purposes, their conformity to legal forms is not conclusive. Although a taxpayer has the right to cast his transactions in such form as he chooses, \* \* \* the Government is not required to acquiesce in the taxpayer's election of form as necessarily indicating the character of the transaction upon which his tax is to be determined. \* \* \* The Government is not bound to recognize as the substance or character of a transaction a technically elegant arrangement which a lawyer's ingenuity has devised. \* \* \*

The record before us satisfies us that the partners were in fact investing, and not selling their business for notes. Formal capital was nominal in amount, and grossly inadequate in view of the normal needs of the business operations anticipated. The partners had been in the same business for many years, and we are satisfied that they were well aware of this inadequacy.

We do not have to decide here whether inadequate capitalization standing alone justifies the treatment of amounts alleged to represent indebtedness as invested capital. Cf. *Erard A. Matthiessen*, 16 T.C. 781, affirmed, 194 F. 2d 659 (C.A. 2). At any rate, it at least invites close scrutiny. *Alfred R. Bachrach*, 18 T.C. 479, affirmed per curiam, 205 F. 2d 151 (C.A. 2). Here the purported indebtedness arose as a result of pro rata advances by all the shareholders; it was created at the time of incorporation when the need for substantial additional permanently invested capital was apparent to the stockholders; all of the stock of the corporation was closely held by three brothers who had also been partners in the business which was being incorporated; and we can find no business purpose other than hoped-for avoidance of taxes necessitating a predominant debt structure and capital stock of a nominal declared value. *Isidor Dobkin*, supra; *Swoby Corporation*, 9 T.C. 887; *Edward A. Janeway*, 2 T.C. 197, affirmed, 147 F. 2d 602 (C.A. 2). Cf. *Ruspyn Corporation*, supra; *Clyde Bacon, Inc.*, 4 T.C. 1107.

In the *Dobkin* case, supra, we said (15 T.C. at p. 32):

Ordinarily contributions by stockholders to their corporations are regarded as capital contributions that increase the cost basis of their stock, \* \* \* Especially is this true when the capital stock of the corporation is issued for a minimum or nominal amount and the con-

tributions which the stockholders designate as loans are in direct proportion to their shareholdings. Edward G. Janeway, *supra*.

When the organizers of a new enterprise arbitrarily designate as loans the major portion of the funds they lay out in order to get the business established and under way, a strong inference arises that the entire amount paid in is a contribution to the corporation's capital and is placed at risk in the business \* \* \*

The State of Oregon requires that corporations with no par stock have at least \$1,000 formally designated as invested capital. Ore. Comp. Laws, Sec. 77-228. Petitioner admits on brief that one of the purposes of the partners was to "limit the capital of the company to a bare minimum allowed by the corporation laws of the State of Oregon." While we would have so concluded independently, the above admission makes it even more apparent that the amount of \$1,050 formally designated as invested capital was totally unrelated to any estimate of the actual need for capital investment, and was selected as the lowest round figure conveniently divisible into three equal parts which would satisfy State law. That amount bore no relation to the amount the partners knew would have to be permanently tied up in the business, and is not a bona fide measure of their capital investment. As we said in *Sam Schnitzer*, *supra*, 13 T.C. at p. 62:

\* \* \* The testimony of petitioner's witnesses,  
\* \* \* that the shareholders never intended



to invest more than \$187,800 in stock is intelligible only as showing an agreement about mere form.

Petitioner has attempted to convince the Court that the denominated capitalization was not in fact inadequate by emphasizing the prior history of high earnings and the promising future that faced the business in 1946. The answer to this argument is also found in *Sam Schnitzer, supra*, where we said at p. 61:

Petitioners argue that large operation profits were reasonably anticipated \* \* \*. In support they stress the mill's substantial earnings in recent years and the unexpected difficulties which they encountered in erecting it. This argument lacks persuasive force. Even if the corporation had paid off the balance in its open account with [the partnership] from earnings, such payment would still have partaken of the character of dividend distributions on risked capital invested in the plant. A corporation's financial structure in which a wholly inadequate part of the investment is attributed to stock while the bulk is represented by bonds or other evidence of indebtedness to stockholders is lacking in the substance necessary for recognition for tax purposes, and must be interpreted in accordance with realities \* \* \*.

We do not deem it a distinguishing feature that in the *Schnitzer* case the expectation of high earn-

ings was initially disappointed whereas in the case at bar it was fully satisfied. The language of that case indicates that such fact would have made no difference, and we agree that it should not.

Petitioner has cited *John Kelley Co. v. Commissioner*, 326 U.S. 521. That case, however, is of no aid to petitioner, for the very important factor of inadequate capitalization was found to be absent there. The Court did allude to just the situation we have here, however, in language which can be of no comfort to petitioner, saying at p. 526:

As material amounts of capital were invested in stock, we need not consider the effect of extreme situations such as nominal stock investments and an obviously excessive debt structure.

See also *Ruspyn Corporation*, supra, 18 T. C. at p. 777; *Swoby Corporation*, supra, 9 T.C. at 893; *Erard A. Matthiessen*, supra, 16 T. C. at 785; *Edward W. Janeway*, supra, 2 T. C. at 202, R. E. Nelson, 19 T. C. 575, 579. *Sheldon Tauber*, 24 T. C. —(No. 24), is distinguishable, in that the Court there was of the opinion that the facts showed no undercapitalization.

The record in the instant proceeding satisfies us that there was no valid business purpose which dictated the gross undercapitalization here present. There seems to be no question that sound reasons existed for forming a corporation to carry on the business, which had been operating up to that time

as a copartnership, but every advantage sought through incorporation, except that of the avoidance of taxes, could have been accomplished with equal facility and assurance of success by the more normal method of the issuance of capital stock of a par or declared value more nearly commensurate with the total amount permanently contributed to the corporation, and with which it was expected thereafter to conduct its affairs. In Mullin Building Corporation, *supra*, the point was disposed of by saying (9 T.C. at p. 358):

Petitioner claims that the purpose \* \* \* was to satisfy James Mullin's desire to establish a steady income for his family and improve the sales company's credit position. The creation of petitioner accomplished these purposes just as fully by treating the debenture stock as an investment creating a proprietary interest as by treating it as an evidence of debt. \* \* \* It was not necessary to create a 29 to 1 debt to capital ratio \* \* \* to accomplish these ends. \* \* \*

It may be quite true that the discovery of cancer in the decedent motivated the formation of the corporation so as to provide for continuity of the business in the event of death of one of the three brothers or in other circumstances. There was thus adequate business reason for incorporating the enterprise. But there was no business reason apparent on this record that called for such an absurdly low capitalization as petitioner asks us to accept at face. The argument that there was a business reason

for incorporating the enterprise is merely a smoke screen that may be calculated to hide the absence of any business reason for attempting to achieve the result in the form that was employed.

It has not escaped our attention that the notes in question are secured, and were not expressly subordinated to obligations of other creditors. Viewing, however, as we must, all the surrounding facts, this circumstance is not impressive. This, in our opinion, is again a matter of perfection of form, wherein what was in fact capital investment has been garbed in the raiment of indebtedness. In addition, we have serious doubts as to the extent to which such security would be upheld as against the claims of outside creditors, should the attempt to do so ever have to be made, as in bankruptcy. In *Arnold v. Phillips*, 117 F. 2d 497 (C.A. 5) certiorari denied, 313 U. S. 583, a deed of trust was made in favor of the dominant stockholder as security for advances already made and to be made in the future. The stockholder later foreclosed on his security. Subsequently, the deed of trust and foreclosure were set aside by the bankruptcy court, even in the absence of fraud, on the ground that there was an inadequacy of original capital, of which the stockholder was aware. The advances were treated as stock subscriptions, and payments thereon, designed as interest, were held to constitute dividends.

Since we have concluded that there was no indebtedness, it must follow that all payments pur-

portedly made on the notes, including those denominated as payments of principal, must in fact constitute taxable dividends within Section 115(a) of the Internal Revenue Code of 1939 to the extent of available earnings and profits. As was said in *Gooding Amusement Co.*, supra, 23 T.C. at p. 421:

\* \* \* Since the notes did not, in reality, represent creditor interests, the payments made to the stockholders \* \* \* must be considered not as payments of a bona fide indebtedness of the corporation, but as distributions of corporate profits to the stockholders as stockholders and not as creditors. Therefore, we conclude that they constituted dividends under the broad language of Section 115(a) \* \* \* The fact that the corporation, or rather the petitioner, may have had no intention of distributing earnings under the guise of discharging debts is immaterial.

For the foregoing reasons and on the strength of the above authorities, we decide the first issue in favor of the respondent.

The second issue is the applicability of Section 112(b)(5) of the Internal Revenue Code of 1939. This issue must be resolved in favor of the respondent for reasons that have already been set forth as determinative of the first issue. We have previously concluded that there was no true debt, and that all the assets transferred to the corporation in May and June of 1946 represented invested capital. The true consideration for this transfer consisted of the

shares of capital stock of the corporation, all of which were issued to the transferors in proportion to their respective interest in the property transferred by them. The notes are a mere sham, and have no reality. The transaction, thus viewed, falls squarely within the provisions of Section 112(b)(5). "Since we have found \* \* \* the notes \* \* \* in fact representative of risk capital invested in the nature of stock, the 'solely in exchange for stocks or securities' requirement of Section 112(b)(5) was, in our considered judgment, satisfied." Gooding Amusement Co., *supra*, at p. 423.

"Property" includes money, so the fact that cash as well as business assets were contributed cannot affect this result. *Halliburton v. Commissioner*, 78 F. 2d 265 (C.A. 9); *George M. Holstein, III*, 23 T.C.....

Section 112(b)(5) is applicable, and the basis of the assets transferred to the corporation is, pursuant to Section 113(a)(8) of the Internal Revenue Code of 1939, the same as that in the hands of the transferors, no gain having been properly recognized with respect thereto on the transfer. Accordingly, the amount of earnings and profits available for distribution as a dividend, and the amount of the deficiency are as asserted by the respondent in his notice.

Decisions will be entered for the respondent.

Served August 23, 1955.

Filed August 23, 1955.

The Tax Court of the United States  
Washington

Docket No. 28582

Estate of HERBERT B. MILLER, Deceased, THE  
UNITED STATES NATIONAL BANK OF  
PORTLAND (Oregon), Administrator, d.b.n.,  
c.t.a.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed August 23, 1955, it is

Ordered and Decided: That there is a deficiency in income tax of \$1,882.27 for the year 1946.

/s/ ARNOLD RAUM,  
Judge.

Served August 24, 1955.

Entered August 24, 1955.

The Tax Court of the United States  
Washington

Docket No. 31063

Estate of HERBERT B. MILLER, Deceased, THE  
UNITED STATES NATIONAL BANK OF  
PORTLAND (Oregon), Administrator, d.b.n.,  
c.t.a.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed August 23, 1955, it is

Ordered and Decided: That there is a deficiency in income tax of \$3,982.35 for the year 1947.

/s/ ARNOLD RAUM,

Judge.

Served August 24, 1955.

Entered August 24, 1955.



In The United States Court of Appeals  
For the Ninth Circuit

Docket No. 28582

[Title of Cause.]

PETITION FOR REVIEW

The United States National Bank of Portland (Oregon), Administrator, d.b.n., c.t.a., of the Estate of Herbert B. Miller, Deceased, petitioner in this cause, by George W. Miller, counsel, hereby files its petition for a review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States rendered on August 24, 1955 (24 TC No. 103, No. 28582), determining a deficiency in deceased, Herbert B. Miller's income tax of \$1,882.27 for the year 1946 and respectfully shows:

I.

The decedent, Herbert B. Miller, filed his income tax return for the year 1946 with the Collector of Internal Revenue, Portland, Oregon.

II.

Nature of Controversy

The controversy involves the proper determination of the deceased Herbert B. Miller's income tax for the year 1946.

In 1946, taxpayer and his two brothers, who were partners, determined to operate their paint manu-

facturing business in a corporate form. A corporation, Miller Paint Co., Inc., was organized with 300 shares no par stock issued and paid for in cash at the rate of \$3.50 per share or a total sum of \$1,050.00. Herbert B. Miller owned 100 shares. The deceased, Herbert B. Miller and his brothers sold the operating assets of the partnership to the corporation at market value, loaned \$50,000.00 in cash to the corporation and received from the corporation in equal amounts promissory notes totaling \$174,571.26. The sale of the assets at market value resulted in a capital gain which the deceased taxpayer reported and paid tax thereon.

In 1946, Miller Paint Co., Inc. paid to deceased taxpayer a payment upon the principal of the notes.

The Commissioner of Internal Revenue held: (1) That the payment on the principal of the notes was a dividend reportable by the taxpayer as income, and (2) that the sale of the operating assets of the corporation, including the cash loaned, constituted a transfer governed by the nonrecognition of gain or loss provision of Section 112(b)(5) and the basis provision of 113 (a)(8) of the Internal Revenue Code of 1939, which holding resulted in the deficiency aforesaid. The Tax Court of the United States sustained the Commissioner.

### III.

The said petitioner, being aggrieved by the findings of fact and conclusions of law contained in the findings and opinion of the Tax Court of the United

States and by its decision entered pursuant thereto, does hereby apply for a review thereof by the United States Court of Appeals for the Ninth Circuit.

/s/ GEORGE W. MILLER,

/s/ DAVID S. PATTULLO,  
Counsel for Petitioner.

Duly verified.

Received November 17, 1955.

Filed November 17, 1955, T.C.U.S.

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In the United States Court of Appeals  
For the Ninth Circuit

Docket No. 28582

[Title of Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To: Chief Counsel, Internal Revenue Service,  
Washington, D. C.

You are hereby notified that the petitioner, on the 17th day of November, 1955, filed with the Clerk of the Tax Court of the United States at Washington, D. C., a Petition for Review of the decision of the Tax Court of the United States heretofore rendered in the above entitled cause. A copy of the Petition for Review is hereto attached and served upon you.

Dated at Portland, Oregon, this 18th day of November, 1955.

Respectfully,

/s/ GEORGE W. MILLER,  
Counsel for Petitioner.

Receipt of copy acknowledged.

Filed November 21, 1955, T.C.U.S.

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[Title of Tax Court and Cause.]

Docket Nos. 28582 and 31063

### STATEMENT OF POINTS

Comes now the Petitioner, above named, by its attorney, George Miller, and hereby asserts the following errors upon which it intends to urge upon review by the United States Court of Appeals for the Ninth Circuit of the decisions of the Tax Court of the United States on August 24, 1955, rendered in Docket Nos. 28582 and 31063.

1. The Tax Court erred in holding that any deficiency exists with respect to the deceased, Herbert B. Miller's personal income taxes for the taxable years ending December 31, 1946, and December 31, 1947.

2. The Tax Court erred in holding that payments made upon the principal of promissory notes held by the decedent and issued by Miller Paint Company, Inc. constituted taxable dividends within Section 115 (a) of the Internal Revenue Code of

1939 to the extent of the available earnings and profits of the corporation.

3. The Tax Court erred in holding that the sale of various assets of a predecessor partnership at market value to Miller Paint Company, Inc., together with a contemporaneous loan of cash for issuance by the corporation of notes payable to the decedent partner was a transfer of assets "solely in exchange for stock or securities" within the non-recognition of gain or loss provisions of Section 112 (b)(5) of the Internal Revenue Code of 1939.

4. The Court erred in holding the sum representing the declared value of the capital stock of Miller Paint Company, Inc., was grossly inadequate to operate the business; the low stated value of the capital stock was a fiction; the risk capital actually contributed to the corporation was represented by the operating assets and cash; no bona fide indebtedness was created by the notes; and the true consideration for the cash and operating assets was the stock alone.

5. The Court erred in failing to find that the issuance of the notes did not create a bona fide debtor-creditor relationship between the taxpayer and Miller Paint Company, Inc. and that the payments received by taxpayer upon the principal of the notes were a return of capital.

6. The Court erred in failing to hold that the substance of the business transaction at issue was identical to its form.

7. The Tax Court erred in that its opinion and decisions are not supported by, and are contrary to the law and the evidence and the Findings of Fact and other facts established by competent and uncontradicted proof which were not found by the Tax Court.

McCARTY, SWINDELLS,  
MILLER & McLAUGHLIN,  
DAVID S. PATTULLO,

/s/ GEORGE W. MILLER,  
Attorneys for Petitioner.

Service of copy acknowledged.

Filed December 6, 1955, T.C.U.S.

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[Title of Tax Court and Cause.]

Nos. 28582, 31063

### ORDER ENLARGING TIME

For cause, it is

Ordered: That the time for filing the record on appeal and docketing the appeal in the United States Court of Appeals for the Ninth Circuit is extended to February 15, 1956.

/s/ STEPHEN E. RICE,  
Acting Chief Judge.

Dated: Washington, D.C. December 20, 1955.

Served December 21, 1955.

The Tax Court of the United States

Docket No. 28582

Estate of HERBERT B. MILLER,

Deceased, et al.,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 31063

Estate of HERBERT B. MILLER,

Deceased, et al.,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

## TRANSCRIPT OF PROCEEDINGS

Monday, October 11, 1954

The above-entitled matter came on for hearing pursuant to notice to the parties, at 2:25 o'clock p.m.

Before: Honorable Arnold Raum, J.

### Appearances:

GEORGE W. MILLER, ESQ.,

DAVID S. PATTULLO, ESQ.,

For the Petitioners.

JOHN H. WELCH, ESQ.,

For the Respondent.

The Court: Are you ready to proceed, gentlemen?

The Clerk: Docket No. 28582, estate of Herbert B. Miller, deceased, et al., and Docket No. 31063, estate of Herbert B. Miller, deceased, et al.

Kindly state your appearances for the record.

Mr. Miller: George W. Miller, attorney for the petitioner.

Mr. Welch: John H. Welch, appearing for the respondent.

Mr. Pattullo: David S. Pattullo, for the petitioner.

The Court: Proceed.

Mr. Miller: If the Court please, in the matter of Docket No. 31063, we respectfully move the Court to file a first amended petition in that case, to bring the allegations of that petition directly in line and in conformity to those in Docket No. 28582. This amendment has already been submitted to opposing counsel and I understand he does not oppose the amendment.

Mr. Welch: I was handed a copy of the first amended petition Saturday and I have not had time to prepare an amended answer, or answer to the petition as amended.

The Court: Do you object to the filing of the petition?

Mr. Welch: I do not object to the filing. I [4\*] merely wish time to submit an answer to the petition.

The Court: How much time would you like?

Mr. Welch: A week.

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\*Page numbering appearing at top of page of original Reporter's Transcript of Record.



Mr. Miller: Very well.

The Court: The amended petition will be received and the respondent may have ten days within which to file his responsive pleading.

Mr. Miller: If the Court please, we respectfully move to consolidate these two docket numbers for trial.

Mr. Welch: No objection.

The Court: They will be consolidated.

Mr. Welch: The parties have entered into a written stipulation of facts in this proceeding, which contemplates the major portion of the evidence in the case. What I wish to present is the original and two copies of a written stipulation. In the stipulation we have identified various tax returns and other documents, various letters and numbers. They are not attached to the petition or made a part of it. They are merely identified in the petition, and I would like to at this time——

The Court (Interrupting): Do you mean in the stipulation?

Mr. Welch: In the stipulation, yes, sir. And I have marked them as is shown here, with a 1-A, et cetera.

The Court: Are they identified in the stipulation?

Mr. Welch: They are identified in the stipulation, [5] in the manner in which——

The Court (Interrupting): Very well, the stipulation will be received and the accompanying exhibits will be treated as part of the stipulation. Is

that in accordance with the understanding of counsel?

Mr. Welch: With one reservation, your Honor.

Mr. Miller: That is in accordance, your Honor.

Mr. Welch: In the last paragraph of the stipulation, which is paragraph 17, we have identified certain photostatic copies of documents which petitioner expects to introduce in this proceeding. Now, it's the respondent's position that if those documents are properly proved to be part of this case, both as to materiality and competency, then we have no objection to the photostatic copies being admitted. But I have endeavored here to reserve all rights with respect to the admission of those documents.

The Court: You are admitting their authenticity and accuracy?

Mr. Welch: Yes, but not their competency or their relevancy or materiality.

The Court: The stipulation and accompanying exhibits will be received.

Mr. Miller: If the Court please, proceeding with the opening statement, if the Court is ready, that, generally, both cases have two principal issues involved. One was whether or [6] not there was a reorganization under Section 112 (b)(5) of the 1939 code from a partnership to a corporation, so that there was a tax-free reorganization, as distinguished from a taxable transfer of some type, it being the government's contention in this particular case that there was a tax-free reorganization, it being our contention that there was not. Then again, the further principal problem is the question which—

The Court (Interrupting): 112 (b)(5) deals with a tax-free exchange, not a tax-free reorganization.

Mr. Miller: I misspoke myself, your Honor.

The other principal problem stems around the outline of these thin incorporation cases, as to whether or not certain assets which came into the hands of a new corporation, whether they were taken as a result of a purchase, creating a debt situation in the hands of the previous partners. This, of course, raises the question, again the principal question that is involved in this case, does the repayment of the debt constitute a taxable dividend to the recipients? The taxes involved are for two years, that are particularly at issue in these two cases, the years 1946 and 1947. The deficiencies are in the amount of \$1,882.27 for 1946 and \$3,982.35 for 1947. All of these taxes are at issue with the exception of a very small \$29 item which can probably eventually be audited out.

A brief background of this situation: The [7] Miller Paint Company is a local organization here in Portland, Oregon. It manufactures and sells at wholesale and retail paints and painting supplies. Along about 1946, we will take the early part of that, there were three brothers who owned the business in equal shares and operated under a partnership called the Miller Co. They had been together for about 30 years as equal shareholders—equal partners, rather. This was a family-run organization. About 1943 or 1944 Herbert B. Miller, now deceased, began to be sick, and this was very early, I think the evidence will show, called to the attention

of his two brothers, his two partners. We had a situation there then where we had a partnership where one of the partners possibly might not be living too long a time. So the partners became concerned—we think that the evidence will show this—in the continuity of the business; the first thing, the proper method of the liquidation of the interest of Herbert B. Miller in the partnership; the next, probably, that they had in their minds was just the mere simplification of the administration of the estate under the Oregon probate law, being there was a partnership interest involved; and one of the other partners had also a plan—the evidence will show this—that he wanted to leave some part of his capital stock, or all, to his employees.

Now, some general outline of the capacity, or the marital situation, of these parties would, I think, kind of point up the picture to you. Herbert B. Miller, the deceased the [8] evidence will show, had a wife and one child, a boy. Walter Miller, the other brother, was unmarried. Ernest Miller, the older brother, was married and had no children. With that background, as I said, one of the brothers, particularly Ernest, felt that his share in this business should properly be distributed to some of the old and faithful employees. And they went to counsel for this—the counsel is here to testify—to secure advice about what to do about this situation, which, they felt, was going to be imminent. And on the advice of counsel they took steps, and we think the evidence is conclusive and will absolutely show this, in that they valued the physical assets that were

used by the partnership—and I might say these are personal property as distinguished from real property, they did control some real property, but it was leased to the Miller Paint Co., which was the selling and manufacturing organization for paint, it was principally all personal property, no real property involved—they valued these physical assets, as we shall call them, at their fair market value and they organized a corporation with what we might as well frankly admit, in other words, now as probably the lowest possible valuation with regard to capital stock. No-par-value corporations, I think our legal briefs will show, they have to have at least a thousand dollars to commence to do business. The capital stock, they authorized 300 shares at \$3.50 apiece. They subscribed to those shares individually and paid for them by cash, the [9] evidence will show, from their own personal bank accounts. They then bought—we re-insist there was a sale—they bought the physical assets of the partnership that were used—

The Court (Interrupting): You mean the corporation bought?

Mr. Miller: The corporation bought the physical assets of the partnership that were used in the paint business, and they gave promissory notes in payment. They then valued a few little cats and dogs, principally, together with the accounts receivable which were there in the partnership and the corporation assumed the accounts payable, took over the accounts receivable and gave another note for the difference to the partners. At the same time they

drew \$50,000 out of their bank account, I think the evidence will show, and they loaned that on another promissory note to the corporation, so that we have—one more thing they did, they gave a mortgage, the corporation gave a mortgage to the partners jointly to secure, not the \$50,000 but to secure the, shall we call it, the note payable for the physical assets and the note payable for the accounts receivable, less the accounts payable. This ended up, I think the evidence is clear, with a debt structure of \$174,000 which was owing to the partners, and through, step by step, that was eventually spread out into six notes of equal amount, three in the amount of \$28,000 and three more of twenty-nine thousand some odd dollars. The evidence will show at the present time [10] that the \$28,000 notes, payable to each one of these three partners and also to the decedent, are also all paid off at the present time, and the evidence will further show that the \$29,000 notes have not yet been paid.

The longest term provided on any of these notes was six years. They will show, they will be offered into evidence, and we, of course, take the position that they were short-term obligations and that this was warranted by the earning capacity of the business.

Now, as part of the principal on the \$28,000 notes was paid off, in 1946 and '49, \$7,500 in 1946 and ten thousand in 1947, the government took the position, finally, that those were taxable dividends to the extent that they were paid out of earned income in the

corporation. And that is why you find the odd amounts with respect to this dividend income.

In 1948, on February 13, Herbert Miller died. Our evidence will show that the stock, which he paid \$3.50 a share for, was inventoried in the estate, in the federal estate tax return, at a value of three hundred forty-seven dollars and some odd cents per share, and that the method of valuing the stock was based directly upon a capitalization of the earnings record. The notes were inventoried and appraised, were included in the federal and state tax returns at their face value and, in turn, they became part of the probate. Later the stock and the notes were transferred to a trustee, the United States [11] National Bank, which is the same organization which acted in another capacity, as the petitioner in this case, and that situation is, as our evidence will show, and under the terms of the will, will show now that the widow is entitled to a life income from the trust. It was after this that our deficiency notice came in with respect to the taxes which are under litigation here.

The Court: Is there an identical issue with respect to each of the three brothers?

Mr. Miller: What?

The Court: Is there an identical issue with respect to the—to each of the three brothers.

Mr. Miller: At the risk of going out of the record—

The Court (Interrupting): I am just inquiring as to an analysis as to whether the same problem exists with respect to each of the other two.

Mr. Miller: The other two brothers are still living. Therefore, to that extent, there is not the same problem.

The Court: Did they receive distributions on their notes?

Mr. Miller: They received distributions in like amounts. They, in other words, also received deficiency notices. As a matter of fact, those were paid and refund claims have been put in. Some of them have been denied just a short time ago. These are the only two cases which went to [12] the Tax Court. In other words, they were brought here by the bank to the Tax Court. The brothers and the widow personally, and one brother's wife, for all of the years involved, didn't stop the payment of interest and so forth, paid to deficiency, and are proceeding the other way. There is a sizeable, as you can imagine, amount of taxes that possibly may hinge upon the decision in this case.

One particular circumstance which we think the evidence will show, it points out some of the problem in this case, which we hope can be answered, it was in 1949 that a further payment was made on the principal of the same notes that are the source of the deficiencies in the years at issue. And in those years the testament of trust was taxed, they required a distributable dividend. At the same time, for the same amount of money, the widow was taxed as it being distributable from the trust. So the same sum of money was taxed in two different hands. So that, in generally outlining the situation, the evidence, in order to understand the situation as to



what might be involved, the trust and the estate and what has happened with respect to the probated estate are very definite considerations in this matter. It is the petitioner's position that, number one, there was no tax-free transfer under 112 (b) (5) and that the repayment of the indebtedness on these notes is not a taxable dividend to the recipient but rather a repayment of a debt. [13]

Mr. Welch: If it please the Court, I would like to point out what I consider the limitations on the issue involved in this particular proceeding. The statutory notice in each docket speaks for itself to this extent, it says that it has been determined that the \$10,000 amount that the decedent received from Miller Paint Company, Inc., and excluded from gross income, included a taxable distribution in the amount of \$9,687.36. Now, that is the respondent's determination. In order to enlighten the Court, we have endeavored to stipulate considerable background information. As a part of the stipulation we have included a statutory notice which was addressed to the corporation which more or less parallels the adjustments that were made in the income tax liability of Herbert B. Miller. In order to fully enlighten the Court, we have also introduced information with respect to the partnership, including the partnership and income-tax return, so that the Court will have the tax returns and the various proposed deficiency letters and statutory notices addressed to these various taxpayers. And we have also included in the stipulation a computation showing how we arrived at the amount of available earn-

ings and profits, which we consider were available for distribution at the time of these payments.

The Court: Is there any dispute between the parties as to the amount of earnings and profits, assuming that this did constitute a distribution? I understand the petitioner's [14] principal position is that this isn't a distribution, this transaction is in truth and in fact what it appears to be on its face, namely the payment of a note. My inquiry to the petitioner now is that, should he fail to sustain that position, does he contest the amount of earnings and profits to the corporation as being insufficient to support the distribution that the Commissioner has charged the petitioner with?

Mr. Miller: There would be an adjustment, if the Court would rule in our favor, that this was not a tax-free exchange, then that computation would have to go out the window because there would be a different basis of depreciation, and of course some minor adjustments would have to be made. I might say, though, there is no substantial dispute with respect to it. It's a matter of mathematics completely, Your Honor.

The Court: There is nothing for the Court to adjudicate, then?

Mr. Miller: It's a matter of computation of the tax after the Court rules on the basic issues.

Mr. Welch: I might point this out, Your Honor, in the statutory notice to the corporation certain deductions for interest were disallowed and treated as distributions of dividends. Now, those are picked up in this computation. They have been eliminated

from the available earnings and profit for the simple reason that they were actually paid and consequently wouldn't remain on the books. The other adjustments, to income, [15] were mainly those relating to depreciation, because of our refusal to permit the corporation to depreciate on the basis of the step-up in value at the time of the formation of the corporation. At least, respondent's position is that the book value and the assets on the books of the partnership would be the book value under Section 113(a)(7) of the Internal Revenue Code. So the controversy, as I see it, is on the question of the petitioner's principal contention that there was a sale which was in consideration of the delivery of certain purported notes. It's the government's position that, at least we haven't admitted so far, that these were actually notes, as far as we are concerned, those notes are merely indicative of risk capital because the total stock issuance of this corporation was \$1,050, and the notes had a face value of some one hundred seventy-four thousand dollars.

In arguing this case, I propose to make reference to the cases involving thin incorporations, because——

The Court (Interrupting): Is there any doubt that this is a 112(b)(5) case at least in the extent of the stock that was issued to the partners?

Mr. Welch: As I understand this section it's an exchange of assets for stock and securities. Now, I do propose to argue that these notes are securities within the meaning of Section 112(b)(5) of the Internal Revenue Code.

Mr. Miller: No stock, Your Honor, and it's not their [16] contention, either, was acquired—and the stipulation takes care of that—for any of the assets of the partnership. The stock was paid for out of the personal bank accounts, \$1,050. That is admitted. The only question we are talking about is the notes that are involved, and they encompass all items of value that were acquired from the former partnership. The stock itself, he is right, it is my understanding, too, the question is whether these are securities, there is another problem within the meaning of that section, being short-term notes.

Mr. Welch: I think that is all, Your Honor, except I do want to point out that the reference made by petitioner's counsel to the year 1949 and what the government did with respect to the widow and the trust, I consider irrelevant and not necessary in this proceeding for the decision of the case. We are dealing here with the actual years 1946 and 1947, of an individual. Although there is a lot of this background references material in here to enlighten the Court, the only thing that we are asking Your Honor to decide is whether these payments were for the distribution of dividends to the extent of available earnings and profits.

Mr. Miller: If the Court please, may I have the exhibits.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record. [17]

The Court: In connection with the stipulation of facts, as a result of discussion that I have just had with counsel off the record, it is my understanding that the agreement between counsel that Exhibits 1 through 16, referred to in the stipulation of facts, shall be received as part of the stipulation and as part of the record in this case.

Will you indicate your agreement to that, counsel?

Mr. Welch: Yes, respondent is in agreement with that.

Mr. Miller: Petitioner is in agreement.

The Court: Very well.

Off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Welch: I would like to have the record show, Your Honor, that Exhibits H, I and joint Exhibits 1-A, 2-B, 3-C, 4-D, 5-E, 6-F, 7-G and 8-J, 9-K, 10-G are to be considered as a part of the stipulation of facts previously offered and received.

Mr. Miller: Petitioner agrees.

The Court: Very well.

Proceed.

Mr. Miller: I might say, in just further explanation of one factor, I might call the Court's attention to this, that when the sale of the assets was made, from the partnership to the corporation, they were sold at their fair market value, [18] which was greater than their adjusted value on the books of the partnership, so that there was a capital gain tax paid at that particular time on the sale of those

assets, which appears in the returns that have now been admitted into evidence.

I will call our first witness.

**CHESTER E. McCARTHY**

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address.

The Witness: Chester E. McCarthy.

Mr. Welch: This witness appears as counsel of record in both of these proceedings. I think the Court should be advised to that effect at this time. He is taking the stand as a witness in a proceeding in which he appears as counsel of record.

Mr. Miller: In the amended petition which has been filed, Chester E. McCarthy's name has been eliminated as counsel, so at this time we move to eliminate Chester E. McCarthy as counsel of record in Docket No. 28582, where his name still appears. Chester E. McCarthy will not argue this case or make any further participation in it.

The Court: What is the purpose of the government's calling this to my attention? Do you want me to rule on something? [19]

Mr. Welch: No, I think the Court should be advised and also Mr. McCarthy should be advised so there won't be any mistake, anything happen, either through inadvertence or otherwise, because of the problem involved, of a lawyer testifying in a case where he appears as counsel. And I think that the

(Testimony of Chester E. McCarthy.)

motion to withdraw takes care of the situation. I don't have any further motion to make in that connection.

Direct Examination

By Mr. Miller:

Q. What is your full name?

A. Chester E. McCarthy.

Q. What is your address?

A. A.P.O. 704, care of Postmaster, San Francisco, California, Headquarters 315th Air Division.

Q. What is your profession, Mr. McCarthy?

A. Well, presently I am a Major-General in the United States Air Force on duty in the Far East Air Forces. And prior to going on active duty this last time in April, 1951, I practiced law in the City of Portland, Oregon.

Q. Were you acquainted with Herbert B. Miller, deceased?

A. Yes, I was.

Q. What was your first contact with him?

A. Well, my first contact with Herbert Miller was, oh, some period of time prior to World War II. He was a partner in the Miller Paint Company and I was practicing law in Portland [20] and handled some matters for his company at that time. Then I went on active duty with the United States Army Air Corps in 1942, returned to Portland from overseas about, I think it was March, 1942, returned to the office, the law office, and I again met him and his brothers at that time.

Q. Did they consult you professionally at that

(Testimony of Chester E. McCarthy.)

time? A. They did.

Q. What did they consult you about?

A. The first visit to the office was about, either the latter part of March, first part of April—I have it in my notes there—was concerning their concern for the continuity of their business in the event something should occur, like incapacity or untimely demise of one of the three brothers. And we discussed at that meeting and subsequent ones the best method of putting their business on a continuing basis in the event of the death of one of the brothers.

Q. Were these conversations you had with the decedent or with all of the brothers?

A. The first two or three were with all of the brothers, and then occasionally Herbert Miller would come up by himself or with one of the other brothers, and then on some occasions, the two brothers who are now in the courtroom, Ernest and Walter, came up without Herbert.

Q. Did they make any request for specific legal services to be performed by you? [21]

A. Yes, they did.

Q. What were those?

A. Well, I just stated in general what they were. And then, specifically, when we determined that a corporate method of doing business would probably be preferable to a partnership with take-out insurance policies for the estate of the decedent, I then reoriented myself on the law pertaining to it, got some outside consultation on the matter from Mr.



(Testimony of Chester E. McCarthy.)

Pattullo, and that led to the formation of the corporation.

Also wrapped up in this at the same time was the putting in order of the estate, particularly of Herbert Miller.

Q. Did you have any conversations in the early part of May or late April of 1946 with respect to any estate planning on the part of Herbert B. Miller, deceased?      A. Yes, I did.

Q. What were the nature of those conversations?

A. Well, Herbert—now, you gave me a date there. What was the date again?

Q. The early part of May or the last part of April of 1946.

A. He wanted his will drafted. In addition to that, he was concerned about all of his assets being tied up in the paint company. He wanted to get those out of the company so that he could dispose of them by a testamentary trust or testamentary disposition to his widow in the case of his death and [22] also his minor son. That was tied up in a general conversation, I think it was with Ernest Miller, who had another mission that he wanted to accomplish, by getting his assets out of the company also, he wanted to leave the paint business proper to some of the old employees upon his death. And it was for that reason that we determined to organize the corporation, leaving the business as such, that is, having the business carried on by the corporation, but taking the money assets into the individual hands of the former partners. That is the

(Testimony of Chester E. McCarthy.)

reason the transaction took in the form that it did. And it was right after that that I did form the corporation.

Q. Did you then act as an attorney for the corporation, Miller Paint Co.? A. I did.

Q. As such attorney, did you prepare and type and keep the minutes of that organization?

A. I prepared, dictated the minutes, and they were typed in my office.

Q. During the years 1946 and '47, were you present at all of the meetings of the stockholders and board of directors of Miller Paint Company?

A. I was.

Q. I hand you now exhibit marked "25" pursuant to the stipulation. I will ask you to examine those photostats. Do you recognize them? [23]

A. They are minutes of the Miller Paint Company, pages 10 through—well, now, wait a minute—pages 10, 16, 17—on page 17 appears the signatures of Walter Miller as secretary and H. B. Miller as chairman. On page 18, on the minutes of the meeting of June 3, 1946, are the signatures of the three Miller boys. And pages 19, 20, 21 with signatures, 23, 24 with signatures—these are copies of—

Q. (Interrupting): Have you had occasion to read those minutes, reread those minutes just recently? A. Yes, I have.

Q. Are they accurate minutes, of exactly what transpired as of the dates that are indicated within those transcribed minutes?

A. They are. They are a correct recording of

(Testimony of Chester E. McCarthy.)

the actions of the officers of the corporation, acts as of the date they bore. They may not have been actually formulated and signed on that particular date, but they were the actions as of the date they bear.

Mr. Miller: I offer those in evidence, Your Honor, Exhibit No. 25.

Q. (By Mr. Welch): These were typed in your office?

A. The originals were typed in my office, yes, sir.

Q. The originals are in the courtroom?

A. I think they are. [24]

The Witness: Do you have the minute book here?

Mr. Miller: Yes, sir.

Mr. Welch: Thank you.

Mr. Miller: Is there an objection, Mr. Welch?

Mr. Welch: I am entitled to inquire and then make my objection, I understand.

Q. (By Mr. Welch): They were dictated by you, sir?

A. That is right.

Q. Do you recall who was present when you dictated those?

A. Probably at the time the actual dictation was made, no one, because I used either dictaphone or dictagraph, whichever machine I happened to have at that time. I dictated from notes I usually take when I am sitting in on a board of directors meeting or stockholders' meeting.

Q. Do you recall where these meetings were held?

A. My office.

(Testimony of Chester E. McCarthy.)

Q. Your office?

A. Now, I say "my office." There were a couple of meetings which may have been held—I don't think these were the ones, however, it was later on—over at the Miller Paint Company itself. I would sometimes drop by there when the brothers were there. But these were, I am sure, held in my office.

Q. Are you an officer of the corporation?

A. No, sir, I am not.

Q. You were the attorney for the corporation? [25]

A. That is correct.

Q. At the time these meetings were held?

A. That is correct.

Mr. Welch: No objection.

The Court: It will be admitted.

The Clerk: Petitioner's Exhibit 25 admitted in evidence.

(Petitioner's Exhibit No. 25 was received in evidence and marked Exhibit No. 25.)

Q. (By Mr. Miller): I hand you now Exhibit No. 17 and ask you if you recognize those photostats of those documents, as to what they are?

A. I do. They are three promissory notes, each made and executed by the Miller Paint Company. They bear the seal of the Miller Paint Company and the signatures of Herbert B. Miller as president and Walter Miller as secretary. In each case they are the signatures of those officers, that is, the originals of which this was a photostat were prepared in my office and were executed in my office.

(Testimony of Chester E. McCarthy.)

Q. But did you actually prepare the notes?

A. Yes, I did. That is, I supervised their preparation. They were typed by the girl in the office.

Q. The note referred to on page 16 of Exhibit 25, the \$50,000 note, do you recognize that note on Exhibit 17?

A. Yes, it's the second one on the bottom of this, or [26] on this page, Exhibit 17, the second photostat.

Q. And that is the note that is referred to on that particular page?           A. That is correct.

Q. Do you recognize a note in the amount of \$86,622.49, which appears on page 19 of Exhibit 25?

A. Are you sure you have got the right page here—oh, here at the top. It begins on the previous page. It begins at the bottom of page 18 and is concluded at the top of page 19. In other words, the supporting minutes for the note of \$86,622.49 is at the top of Exhibit No. 17.

Q. Now will you refer to page No. 20 of Exhibit No. 25 and examine Exhibit No. 17 and one of the notes thereof and see if that is a note that grew out of the note authorized to be issued on Exhibit 25, page 20?

A. That is correct. It is page 20 of Exhibit 25. This appears to be the supporting minutes for the note at the bottom of the photostatic Exhibit No. 17, \$37,948.77.

Q. Do you recognize the signature of Walter Miller crosswise on those notes?

A. I do. It's on Exhibit 17.

(Testimony of Chester E. McCarthy.)

Q. Are you familiar with his handwriting?

A. I am. That is, I saw him write it.

Mr. Miller: I will offer Exhibit No. 17 in evidence. [27]

Q. (By Mr. Welch): Mr. McCarthy, did you testify that these signatures were placed on there in your presence? A. That is right.

Q. And that this note here with regard to cancellation, you say you saw that written?

A. That is right, it was done in my office.

Q. It was all done in your office. This is a little difficult to read—

A. —Just hold it down this way (demonstrating).

Q. Would you read to the Court the date of the cancellation? A. Well—

Mr. Miller: Would it assist you to examine the original?

A. —July 31, 1946—I will read this one here, I can read it on this one here, I assume these were done all at the same time—July 31, 1946.

Q. (By Mr. Welch): There was no payment at this time, to your knowledge, of any of these?

A. No; there were notes substituted for these in the exact total sums, the transaction merely being one of submitting these notes which were made payable to, I believe, all three brothers, and reissuing notes in the same aggregate sums, but one-third each to the individuals so that it wouldn't tie [28] up the property of two brothers in the event something happened to the third. That was the purpose

(Testimony of Chester E. McCarthy.)

of the cancellation of these notes here, and the substitution, I think, of like date.

Q. To your knowledge, these notes never left your office, then?

A. I won't say that. They were with the—they may have left the office by one of the officers of the company. Sometimes we kept files in our office of Miller Paint Company, and to the extent that those files were labeled "Miller Paint Co.," they were the company's records. I won't say those notes never left my office. They might have.

Q. Two of them bear the date June 1, 1946 and the other bears the date June 3, 1946. And the cancellation was sometime in July, probably July 31?

A. That is right. And I think the variance in those dates, the bottom one which bears the date June 3, was predicated upon some computations which were made of—I am sure that is the one that was for the difference between the accounts receivable and the accounts payable. That probably accounts for the difference in the date. I can tell you in a second here, if you will hand me my book there.

The Witness: Will you hand me my book, Mr. Miller?

Mr. Miller: Yes.

A. —Yes, those notes were probably prepared on June 1, which was a Saturday, and executed, [29] and in anticipation of signing on Monday, June 3. They could have been signed on June 1 also because the Millers were in the office on June 1, 1946.

(Testimony of Chester E. McCarthy.)

Q. That is, Herbert Miler and also Walter Miller were in the office at that time?

A. Yes, sir. And I think probably Ernie was with them on that occasion, and for the several days just previous to that time, they were in and out of the office several times. I can't say—these entries here were not for the purpose of making, of offering testimony. They were records for the purpose of making charges for services rendered. In other words, a record of time devoted to each task and for each client. I do recall that on more than one occasion, a few occasions, Ernest Miller and Walter Miller alone came up. It was on one of those occasions that they gave me the immediate reason for their concern, in changing the business from a co-partnership to one which would permit it to continue in the event of the death of one of the brothers. They had learned that Herbert Miller was afflicted with cancer and that he, so far as they knew, did not know that; his wife knew it, Blanche Miller, and Ernest Miller and Walter Miller knew it, but they did not want to discuss that reason in his presence and it was during his absence that reason was given to me, and that was one of the reasons we put forth quite a bit of pressure in starting a corporation at the earliest possible date, which was agreed upon, I think, June 1. [30]

Mr. Welch: I have no objection.

The Court: Admitted.

The Clerk: Petitioner's Exhibit 17 admitted in evidence.



(Testimony of Chester E. McCarthy.)

(Petitioner's Exhibit No. 17 was received in evidence and marked Petitioner's Exhibit No. 17.)

Q. (By Mr. Miller): I hand you Petitioner's Exhibits 18 and 19 as marked for stipulation, and I ask you to refer to Petitioner's Exhibit No. 25, page No. 23, and determine whether those notes are the substitute notes as mentioned in the minutes of a meeting which was held on July 31, 1946, of the board of directors of Miller Paint Co., Inc.

A. Well, the Exhibit No. 19, with the sum \$29,-316.26, is referred to on page 23 of the minutes identified.

Q. Will you turn to the following page and see if the other note is referred to, Exhibit No. 18?

A. Yes. Exhibit No. 18 is supported by minutes at page 24, that being the sum of \$28,174.16.

Q. Do you recognize the signatures on those notes?

A. I do. Exhibits No. 18 and No. 19 are signed by Miller Paint Co., Inc., by H. B. Miller, President, and Walter Miller, as Secretary, and is also Exhibit No. 19, and each has the corporate seal on it.

Q. Do you know whether those notes were [31] delivered to Herbert Miller? A. They were.

Mr. Miller: I will offer Exhibits—

The Witness (Interrupting): There again, now, I am aware of the stipulation of these, I have testified concerning certified copies, photostatic copies. The originals—

(Testimony of Chester E. McCarthy.)

Mr. Miller (Interrupting): Are in the court-room, in my possession.

The Witness: I wanted the Court to understand that these aren't the originals, these are photostatic copies.

Mr. Miller: I will offer those in evidence, Exhibits 18 and 19.

Q. (By Mr. Welch): Mr. McCarthy, you say, these were prepared and signed in your office?

A. That is correct.

Q. You saw the signatures, is that correct?

A. That is correct.

Q. If you will examine Exhibits 18 and 19 for identification, I see they bear the date, each of them, June 1, 1946. Will you explain how that date happens to appear there?

A. Yes. These were notes which were made to substitute for the ones on Exhibit 17, which notes bore the original date of June 1, and, as I testified a moment ago, we wanted to submit these notes into three parts, each representing the interest [32] of the individual Miller brother, rather than having all three names on one note. So, when these substitutes were prepared and the consolidated notes canceled, I dated them the same date as the notes for which they were substituted. As a matter of fact, the minutes, I can tell you exactly when those notes were prepared, because the minutes which support them show that the meeting was held on the 31st day of July, 1946—I am sure that is the date it was—my date book shows that they were in the

(Testimony of Chester E. McCarthy.)

office on the 31st of July 1946, and the minutes specifically stated that the notes should bear the date of 1 June.

Mr. Welch: There is no objection to Exhibits 18 and 19.

The Court: They are admitted.

The Clerk: Petitioner's Exhibits 18 and 19 admitted in evidence.

(Petitioner's Exhibits Nos. 18 and 19 were received in evidence.)

Q. (By Mr. Miller): Is there anything further, Mr. McCarthy, which you can add, which you can testify to, concerning the formation of this corporation?

A. Only one other thing I can think of—

Mr. Welch (Interrupting): I object to the form of the question. I think I am entitled to a little more specific question than the manner in which it was framed. [33]

Mr. Miller: It's not leading, it certainly isn't. It's a very general question in regard to his recollection.

The Court: I think you had better make the question more specific.

Mr. Miller: That is all.

Mr. Welch: I have no questions, your Honor.

The Court: I would like to ask one thing of the witness. Perhaps he has already so testified, but just so that I might have it clear in my mind.

(Testimony of Chester E. McCarthy.)

By the Court:

Q. I think you spoke once or twice of changing the business from a partnership into a corporation, or using language somewhat to that effect. I would like to know whether the entire series of steps were all contemplated as part of the basic transaction, that is, the incorporation of the new corporation, the issuance of its stock, followed by the transfer of the partnership assets to the new corporation for notes, whether all these were parts, were steps in connection with the basic objective of turning the partnership business into a corporate business?

A. I think probably not, because prior to the actual beginning of business, paint company business by the corporation, it was formed, the corporation was formed a little ahead of that, stock was issued for cash, the stock was paid for by each of the brothers individually by check upon their [34] personal bank account, and the corporation was formed was entitled to do business as a separate entity before the partnership ceased doing business. And, as soon as the administrative work of determining the value at which the assets should be sold and at which the corporation's items were determined, then they were purchased by the corporation from the three Miller brothers and notes were executed for the goods, wares, and merchandise, on the one hand, for certain other personal property such as trucks, some office furniture, as I recall it, some other small amounts of personal property, and then

(Testimony of Chester E. McCarthy.)

some days later, but as a separate transaction, they bought the accounts.

Q. Well, I understand it was a separate step. My question, I think, cuts a little deeper than your answer, and I am not sure that your answer has been responsive to my question. Perhaps my question wasn't clear enough. My question really goes to the point of whether, at the time of the creation of the corporation, it was contemplated that as part of the over-all picture, that the corporation would acquire the operating assets or a substantial portion of them, of the operating assets of the partnership.

A. That is correct.

Q. That was contemplated? A. Yes.

Q. In other words, the so-called transfer of the assets for the notes was contemplated at the very beginning, at the [35] time that the corporation was organized?

A. Not necessarily a transfer of the assets for notes. That was a sale and was kept from the very beginning. It was intended to be and take the form of a sale.

Q. My question is, was it intended that such a transaction should take place from the very beginning—whether you call it a separate transaction or not, that is for me to determine whether it should be treated as separate or not—I am asking you whether that transaction was contemplated from the very beginning.

(Testimony of Chester E. McCarthy.)

A. I don't think that the form or the amounts was, no.

Q. I am not asking you about the amounts. I am asking you whether at the time the corporation was formed, whether it was contemplated that the operating assets of the partnership would be transferred to the new corporation?

A. I think that is a fair statement, yes. I don't know, we never discussed at the initial meetings what would happen to, for instance, the accounts receivable and the accounts payable, that developed when we got the corporation set up, got Mr. Pattullo into the scene, making an audit, but it was intended to operate the Miller Paint Company business as a corporation.

Q. That answers my question, that is, that the corporation, the creation of the new corporation was intended to operate the Miller Paint Company business, that is, that business [36] which had formerly been operated as a partnership?

A. That is correct.

Q. And that various steps would have to be taken subsequent to incorporation in order to achieve that initial objective?

A. Well, the initial objective, your Honor, was, I think it's more accurate perhaps to state that the formation of a corporation was incidental to the main objective. The main objective was to take care of the eventuality which two of the brothers knew was going to take place, in which I checked with the doctor who was treating Herbert Miller, that he was

(Testimony of Chester E. McCarthy.)

afflicted with cancer and his days were numbered. They had previously gone to the United States National Bank, the trust department, some few months before I got back from overseas, investigating a possible method of another type of partnership, or rather an agreement offset by insurance policies, to take one of the partner's estate out in the event of his death. Nothing came of that, but they brought up that fact to me in my office at our initial meetings after I got back here in March. Their main concern was to create an entity which would be continuing upon the death of Herbert Miller, who was then the marked one, and also to permit him to get out of the business cash which he could, which would be unencumbered and would not be tied up in a partnership dissolution in the event of the demise of one of the partners, for his estate, for his wife and his minor son. [37]

Q. From what you tell me, then, I conclude that the creation of the corporation, that is, just the mere framework of the corporation, was the first step toward the corporation's acquiring the operating assets of the business?

A. Well, the formation of the corporation would naturally be a necessary first step before it could do anything, it was formed, its stock paid for and was set up, ready to do business. It couldn't have been otherwise, because it wasn't a legal entity until that was done.

(Testimony of Chester E. McCarthy.)

### Further Direct Examination

By Mr. Miller:

Q. In line with the judge's question, was it contemplated at the time of this formation and the acquiring of the assets of the partnership that those assets, or their value, should have been irretrievably given to the corporation?

A. No, not at all, it was a sale to the corporation.

Mr. Welch: I object to the form of the question. I think it's definitely leading.

Mr. Miller: It's in the same form as the judge asked his question.

The Court: The question may stand.

The Witness: We are all lawyers. I think we know what we are trying to get at here. I didn't go into this blindly. That is for sure. I got tax advice on it, when I knew a tax question would be involved. And I intended to make a sale to [38] the corporation and accept notes in payment for the goods, wares, merchandise and accounts that were transferred over. That is what we intended to do. That is what we did do.

Q. (By Mr. Miller): Did you go into the earning record of the partnership prior to the formation of this corporation?

A. Well, I don't remember whether we did or not. Some of this work was done—my main object at that time was to get the corporation set up, the assets sold to it. Mr. Pattullo was called in for consultation. As a matter of fact, we got quite a little



(Testimony of Chester E. McCarthy.)

ways along before we went into the question which arises in practically every business transaction, that was, tax resulting, because whatever the tax result would have been, this corporation would have been formed, for the reasons already stated, but we did ask Mr. Pattullo for his opinion on the tax effect, tax result on it, and he rendered an opinion to me for, on behalf of, the Miller brothers. But whether I went in to figure up the earnings of the corporation, I can't truthfully say at this time that I did or did not. That has been some eight years ago.

Q. The question was whether you went into the early record of the partnership?

A. I meant partnership, not corporation. I don't know that I did. Mr. Pattullo may have.

Mr. Miller: I think that is all. [39]

### Cross-Examination

By Mr. Welch:

Q. Then, Mr. McCarthy, you virtually ignored the tax problem in this transaction?

A. Ignored it?

Q. Ignored it.

A. No, I surely did not ignore it. That isn't my testimony.

Q. But it is your testimony that the tax effect has no bearing on the actual transaction, so far as consummation is concerned?

A. The tax effect?

Q. Had no effect?

A. It's had an effect obviously, but the real rea-

(Testimony of Chester E. McCarthy.)

son for the organization of the corporation and the initial reason they came to my office, as they stated—I had stated—was to form an entity that would continue the business, on the one hand, after the death of one of the partners, and on the other hand, it would permit that partner to take out his cash for a separate estate, and Ernie Miller would be placed in a position where he could leave, upon his death, the business, without the large cash assets in there, to his employees.

Mr. Welch: I have no further questions.

The Witness: I think the—well, Mr. Pattullo can testify to that—the dates that I saw him were some time subsequent to this. [40]

(Witness excused.)

The Court: We will have a short recess.

(Short recess.)

The Court: The court will be in order.

Mr. Miller: We will call Ernest Miller.

ERNEST MILLER, JR.

was called as a witness by and on behalf of the petitioners, and having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Ernest Miller, Jr., 13310 South Kuehn Road, Portland.

Direct Examination

By Mr. Miller:

Q. Are you the brother of Herbert B. Miller, deceased? A. Right.

Q. Would you outline to the Court generally a little bit of background about the Miller Paint Company prior to 1945?

A. Well, the Miller Paint Company started way back in the early '90's; it was started by my father, as a matter of fact. And I came into the picture about 1909.

Q. Are you the oldest brother? A. Yes, sir.

Q. When did the other brothers come into the picture?

A. Well, they came in, well, Herbert came in about six [41] years later—I think it was six or seven years—and Walter came in another three or four years later. I don't remember exactly the years. And we started in a small way, of course, beginning with a retail store and we gradually branched into the wholesale business and eventually we started a little manufacturing. That is about it.

Q. For about how long prior to 1946 had you,

(Testimony of Ernest Miller, Jr.)

Walter Miller and Ernest Miller, been equal owners of Miller Paint Company?

A. Well, we were equal owners from the time we entered into the business. I would say approximately 25 years, on an average.

Q. Other than this Miller Paint Company, did you and your brothers have any financial dealings among yourselves? A. Occasionally, yes.

Q. What were these occasions?

A. We occasionally bought some securities together, and, of course, we bought real estate together, we bought our properties together. That would be the extent of it.

Q. Have you ever had joint bank accounts?

A. Yes, joint bank accounts, of course.

Q. Were all of these connected with the Miller Paint Company business, these joint bank accounts?

A. Yes.

Q. Starting along about 1943 or 1944, I wish you would [42] outline to the court two things, what problems faced Miller Paint Company as a business, what problems faced the Miller brothers individually? Just outline in your own words—

A. You mean the three Miller brothers?

Q. The individual problems, yes, and then the problems that faced the business itself.

A. Well, first problem that faced my brother Walter and I was the fact that we knew my brother Herbert was going to die. That was one of the most serious problems we had facing us.

Q. To the best of your recollection, when did you

(Testimony of Ernest Miller, Jr.)

first know that? A. That was in 1943.

Q. Did you consider that a business or a personal problem?

A. Well, it was both. It was a business problem, it affected the business, and it affected each one of us individually, that is, it affected my brother Walter and I as individuals.

Q. How did it affect you and your brother Walter individually?

A. Well, we knew if and when my brother Herbert died there would be some complications in the partnership.

Q. What kind of complications would those be?

A. In connection with the distribution of the assets of [43] the business, the partnership. As a matter of fact, I had a consultation with the bank, with a bank executive, and was advised to that effect.

Q. What bank was that?

A. It was the U. S. National Bank.

Q. I hand you Exhibit 24, petitioner's Exhibit No. 24, and ask you if you recognize that photostatic copy of a document? A. Yes, I do.

Q. What is that?

A. That is a letter addressed to myself and my two brothers, outlining a way we could set up the thing to avoid any complications in the event of the death of either one of us.

Q. And the date on that was what?

A. 9/7/1945.

Q. Did you receive this paper from the United

(Testimony of Ernest Miller, Jr.)

States National Bank?           A. Yes.

Mr. Miller: I offer petitioner's Exhibit No. 24 in evidence.

Q. (By Mr. Welch): Mr. Miller, do you know who signed the original of this particular document?

A. It was McKay, I believe. [44]

Q. I ask you to examine the bottom of page 2 and tell me who signed it, if anyone signed it.

A. You mean this initial here, you are referring to?

Q. Well, I don't know what it is.

A. Well, I don't recall that initial, I don't know who that—what that would be.

Q. Will you turn over and look at the face of page 1 of that document and tell me to whom that is addressed, if anybody?

A. Miller Paint Company, 732 Southwest First Avenue, Partners Ernest Miller, Herbert B. Miller and Walter Miller.

Q. Is it your testimony that that is addressed to the Miller Paint Company—

Mr. Miller: Maybe I can clear that up—

Q. (By Mr. Miller): Did you receive it?

Mr. Welch: I will ask the questions, if you don't mind, and then you can inquire further, if you like.

Q. (By Mr. Welch): It is your testimony that it's addressed to Miller Paint Company?

A. Right.

Q. And it says "Re (Colon)." Does that indicate a form of address?

(Testimony of Ernest Miller, Jr.)

A. I suppose, I suppose it does.

Q. On its face, it appears to be a memorandum, not addressed to anyone? [45]

The Court: Well, I think you are arguing with the witness. The paper speaks for itself.

Mr. Welch: I will object to the admission of petitioner's Exhibit for identification No. 24 on the grounds it hasn't been properly identified and on the further grounds it's irrelevant and immaterial.

The Court: I think it was sufficiently identified when this witness said he received it from the bank, and evidently, or apparently, it contains the discussion thus far, it contains considerations and material relating to the continuity of the business. I will admit it.

The Clerk: Petitioner's Exhibit No. 24 admitted.

(Petitioner's Exhibit No. 24 was received in evidence.)

Q. (By Mr. Miller): Did you and your brothers talk over the advice that that memorandum contained? A. Yes.

Q. What was the nature of those conversations, if you recall?

A. Well, we talked about whether it would be advisable to incorporate or not.

Q. Did you do anything immediately with respect to that? A. No.

Q. Do you recall the first meeting between yourself, your [46] brother, Herbert B. Miller, your brother, Walter Miller, and Chester McCarthy?

A. Yes.

(Testimony of Ernest Miller, Jr.)

Q. About what time do you recall that meeting was?

A. Well, it was sometime during the year of 1945. I don't remember the exact date.

Q. Are you positive it was '45? A. Yes.

Q. Do you know when Chester McCarthy returned from the service?

A. No, I don't recall exactly the date he returned from the service.

Q. Was it after he returned from the service that you had the conversation?

A. Yes, it was after he returned.

Q. Did you call upon him for advice with respect to the problems which you were facing?

A. Yes, I did.

Q. Did you outline those problems to him?

A. Yes.

Q. What do you recall were the conversations with respect to the problems that your business faced? Did you outline them to Mr. McCarthy and ask for a solution?

A. Well, the principal thing I talked about was my brother's condition of his health and what should be done about [46A] it, what could be done about it, to avert any trouble, in case something should happen to him, along the lines of this letter that I received from the bank.

Q. Did you discuss with him, in other words, your personal desires with respect to the disposition of the business at your death? A. Yes.



(Testimony of Ernest Miller, Jr.)

Q. What did you tell him in connection with that?

A. Well, I told him in the event of my death, I would, I sort of felt I would like to leave my portion of the business to some of the old, loyal employees. I thought possibly that by incorporating, it would be better handled that way.

Q. Did you want to leave the full value of your business to the employees, that you owned?

A. The full value of the assets of the business, yes.

Q. These meetings in the early part of June, 1946, the latter part of May, 1946, did you attend those meetings, as outlined by Mr. McCarthy on the stand? A. I did.

Q. Do you recall, in other words, from your own independent recollection, what steps were taken in the formation of Miller Paint Co., Inc., and the dissolution of the Miller Paint Co., the partnership?

A. Do you mean what steps were taken in a legal way?

Q. Yes. [47]

A. Well, I couldn't recite them exactly. I don't—they are all down in black and white, the steps that were taken.

Mr. Miller: May I have Exhibit No. 25?

The Clerk: Yes, sir.

Q. (By Mr. Miller): Do you recognize these as meetings of the board of directors of Miller Paint Co., Inc., held on the 20th day of May, 1946, June 3, 1946, and July 31, 1946? A. Yes, I do.

Q. Is it your testimony that those minutes are

(Testimony of Ernest Miller, Jr.)

accurate as to what happened at the meetings on the dates indicated?      A. Yes.

Mr. Miller: That is all.

Cross-Examination

By Mr. Welch:

Q. Mr. Miller, I will hand you Petitioner's Exhibit No. 18, which has been previously identified in this proceeding as a promissory note of Miller Paint Company, Incorporated. I will ask you if your signature appears on that photostat?

A. No, it doesn't.

Q. Do you recognize the other signatures there?

A. Yes.

Q. You are familiar, are you not, with the various notes that are involved in this particular proceeding?      A. Yes.

Q. Would you state to the Court, if you will, the amount [48] of the installment that is set out on the face of the note as being due under this obligation. Starting about the fifth line down. What does that say there (indicating)?

A. "Shall be payable in annual installments of not less than \$166.66 in any one payment, plus the full amount of interest due on this note at the time of payment of each installment."

Q. Well, tell the Court, if you know, what installments were paid. Before you answer that question, I can make this statement, it has been stipulated, for purposes of deciding this case, that your brother, that is, Herbert B. Miller, received \$7,500, on or about November 30, 1946, and \$10,000 on November 30, 1947. Now, what I want you to ex-

(Testimony of Ernest Miller, Jr.)

plain to the Court is why the amounts of the installments are different than is shown on this note.

A. Well, the payments that were made to me were paid on the basis of this note.

Q. Would you know why the payments were larger? A. To Herbert and Walter Miller?

Q. It's been further stipulated that equal amounts were paid to Walter Miller and Ernest Miller, Jr.—

The Court (Interrupting): Are you referring to paragraph 12 of the stipulation?

Mr. Welch: Paragraph 12 of the stipulation.

Q. (By Mr. Welch): What I want you to explain to the Court, if you can, is why the amounts, why the installments, [49] which were actually paid—I don't think there is any controversy about that—are different than the amount set out in that instrument, that is, why more was paid than is set out there.

A. I don't have any recollection of any larger amounts having been paid.

Q. What is your title?

A. Secretary-treasurer.

Q. You have always been the secretary-treasurer? A. At one time I was vice-president.

Q. Has Miller Paint Company, Incorporated, ever paid to the stockholders a dividend other than the amounts which are here in controversy in this proceeding? A. No.

Mr. Miller: I object to that question. That implies there was a dividend. The form of the question

(Testimony of Ernest Miller, Jr.)

implies a yes or no on that. Either one of them would be an admission that there was a dividend. That is the element in issue.

The Court: That is the very question before the Court.

Mr. Miller: That is right.

The Court: I will not assume that the answer that the witness gives to the question admits the only real issue that is before us.

Mr. Miller: If he would care to rephrase the question and ask if any dividend has ever been declared by the board of directors, all right. [50]

Mr. Welch: I have no further questions, your Honor.

The Court: Are you going to seek an answer to that inquiry?

Mr. Welch: Could I have that question reread, for the purpose of my rephrasing it?

(Last question and answer read.)

The Court: I will accept that answer and I will accept it as not admitting the only issue that is before us.

Mr. Welch: Then, I state to the Court I have no further questions.

### Redirect Examination

By Mr. Miller:

Q. Has Miller Paint Company ever declared a dividend since its formation?           A. No.

(Testimony of Ernest Miller, Jr.)

Q. Miller Paint Company, Incorporated?

A. No.

Mr. Miller: That is all.

(Witness excused.)

Mr. Miller: Walter Miller.

WALTER MILLER

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please. [51]

The Witness: Walter Miller, 317 Southeast Grand Avenue, Portland, Oregon.

Direct Examination

By Mr. Miller:

Q. What is your present occupation?

A. I am president of the Miller Paint Company, Inc.

Q. At the time that Miller Paint Company was first incorporated, what was your office?

A. I was secretary-treasurer.

Q. Do you recall, in the latter part of 1945, early part of 1946, the problems that faced Miller Paint Company and yourself, personally, if any?

A. Well, as was stated before, the main problem was the health of our brother Herb, who, we knew, had a diagnosis of cancer and was given a few years to live. And our second problem was to get

(Testimony of Walter Miller.)

our affairs in order so we could continue with our, so the Miller Paint Company could be clear, and to get our assets, I mean our value, out of the Miller partnership. Our thought was to get the Miller Paint incorporated so Miller Paint Company would still keep on going, in the case of the death of any one of our partners.

Q. Do you recall conversations with Chester McCarthy in the latter part of April and the first part of May, 1942?

A. Yes, we had several meetings.

Q. Do you recall any of the conversations in which you [52] went into the earning record of the Miller Paint Company, the partnership?

A. Yes, I recall that very clearly. Mr. McCarthy asked me the earnings of the Miller Paint Company, partnership. And I told him they were very good and so forth, gave him the amounts.

Q. Do you recall those amounts, by any chance, that you gave?      A. You mean profitwise?

Q. Profitwise or—

A. (Interrupting): Well, I don't exactly. I wouldn't want to say. They were substantial amounts. They were very healthy amounts. That was during those days of growing business in the company.

Q. In other words, Miller Paint Company was a profitable business?      A. Yes.

Mr. Miller: May I have Exhibit No. 25, please?

The Clerk: Here (indicating).

Q. (By Mr. Miller): I hand you Petitioner's

(Testimony of Walter Miller.)

Exhibit No. 25, which has been admitted in evidence, which is photostatic copies of minutes of the meetings of the board of directors on the dates of the 20th day of May, 1946, June 3, 1946, and July 31, 1946. I will ask you if you recall those meetings.

A. Yes, these are all all right. I recall them. [53]

Q. Do those minutes reflect exactly what transpired at those meetings? A. That is right.

Q. Does your signature appear on those minutes? A. As secretary, yes.

Mr. Miller: Would you mark these for identification petitioner's 26.

The Clerk: Petitioner's Exhibit No. 26 marked for identification.

(Petitioner's Exhibit No. 26 was marked for identification.)

Mr. Miller: And would you mark this for identification petitioner's 27.

The Clerk: Petitioner's 27 marked for identification.

(Petitioner's Exhibit No. 27 was marked for identification.)

Mr. Miller: And please mark this for identification as petitioner's No. 28.

The Clerk: No. 28 marked for identification.

(Petitioner's Exhibit No. 28 was marked for identification.)

Q. (By Mr. Miller): I hand you Petitioner's

(Testimony of Walter Miller.)

Exhibit No. 26 and ask you if you recognize what it is?      A. Yes, that is our general ledger.

Q. For what period of time? [54]

A. Well, let's see. This is to the first half of 1946. This would be Miller Paint Company, the partnership.

Q. To June 1, 1946?      A. '46, yes.

Q. Does that also contain your journal, too, that book?      A. Yes, I think it does, yes. Yes.

Q. Are those books kept under, were they kept under your supervision?

A. Yes, in my office, right where I have my office.

Q. And you consider them true and accurate in all particulars?      A. Yes, we do.

Mr. Miller: I offer Petitioner's Exhibit No. 26 in evidence.

Q. (By Mr. Welch): This book which has been marked Petitioner's Exhibit No. 26 is the ledger for the partnership?

A. For the first six months of the year.

Q. That is, on the cover it bears the date June 1, 1946? That would be the closing date?

A. That would be the closing date of the partnership, yes.

Q. That would be the closing date of the partnership?      A. Yes.

Mr. Welch: No further questions.

The Court: I will admit Exhibit No. 26 in full, but I [55] admit it only on condition that counsel draw to my attention those portions of 26 that it



(Testimony of Walter Miller.)

wishes the Court to take into account. The Court has no intention of making a fishing expedition through Exhibit No. 26 to find one little piece of evidence on one page and another piece on another in an attempt to construct some theory or other. P-26 will be admitted and considered by the Court only to the extent that the counsel specifically draws attention to portions of 26 that counsel wishes the Court to consider.

Mr. Miller: That is fair enough.

The Clerk: 26 is admitted.

(Petitioner's Exhibit No. 26 was received in evidence.)

Q. (By Mr. Miller): I hand you Petitioner's Exhibit No. 27 and ask you what that is.

A. This is the second half of the, second six months of the corporation here. Let's see, would that be six months?

Q. Is this the corporation books or the partnership books? A. Corporation books.

Q. Is this the ledger and the journal?

A. Yes.

Q. Are they kept under your supervision?

A. That is right.

Q. Would you say they covered the period from June 1, 1946 [56] to November 30, 1946?

A. That is right. Five months.

Q. The fiscal year? A. That is right.

Q. Are these records kept in the ordinary course of business? A. Yes.

(Testimony of Walter Miller.)

Q. And you consider them as true and accurate?

A. Yes.

Mr. Miller: We offer No. 27, subject to the same ruling by the Court.

Mr. Welch: No objection, your Honor.

The Court: Exhibit No. 27 will be admitted subject to the same conditions as 26.

(Petitioner's Exhibit No. 27 was received in evidence.)

Q. (By Mr. Miller): I hand you herewith Petitioner's Exhibit No. 28 and ask you if that is the journal and ledger of Miller Paint Co. beginning December 1, 1946, and ending November 30, 1947.

A. That is right.

Q. Was that book kept under your general supervision? A. It was.

Q. Is it true and accurate in all particulars?

A. It is. [57]

Mr. Miller: We offer Exhibit No. 28.

Mr. Welch: No objection.

The Court: It will be admitted subject to the same conditions as the two preceding exhibits.

The Clerk: Petitioner's Exhibit No. 28 received in evidence.

(Petitioner's Exhibit No. 28 was received in evidence.)

Mr. Miller: May we have permission from the Court to withdraw those for the purpose of preparing photostatic copies?

(Testimony of Walter Miller.)

The Court: I would prefer to work with the originals. If you wish, you may withdraw the copies to work with yourself. But I would prefer to have the originals myself. Similarly, the government may withdraw them at the time it comes to preparing its brief and retain them as long as it wishes prior to the submission of the briefs.

Mr. Welch: May we have them prior to the filing of the briefs?

The Court: For the preparation of your briefs, upon making appropriate request and giving receipts for them.

Mr. Welch: Thank you.

The Court: If there are any difficulties with the ways in obtaining them, I will take that into account and give you an extension of time on your briefs, so that you may have an opportunity to consider the matter. [58]

Mr. Miller: That is all.

#### Cross-Examination

By Mr. Welch:

Q. I want to ask you, Mr. Miller, at the time you became concerned about the business, that is, the Miller Paint Company partnership, and you ultimately participated in the formation of a corporation, was it your intention or desire to continue the business operations as you had in the past?

A. Definitely, yes.

Q. You anticipated no change in your business

(Testimony of Walter Miller.)

or business methods?           A. No, none.

Q. Other than the forming of the corporation?

A. Just practically the same, yes.

Mr. Welch: I have no further questions, your Honor.

Mr. Miller: That is all.

(Witness excused.)

Mr. Miller: I am going to call Mr. Moss.

### H. W. MOSS

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: H. W. Moss, 15007 Southeast Oakfield Road, Portland, Oregon. [59]

### Direct Examination

By Mr. Miller:

Q. Mr. Moss, what is your employment?

A. I am with the United States National Bank of Portland, Oregon.

Q. What is your capacity?

A. I am assistant trust officer and have charge of the income taxes and supervise state and gift taxes.

Q. In connection with your duties at the United States National Bank, are you familiar with the probate of the Herbert B. Miller estate?

A. Yes, I was.

(Testimony of H. W. Moss.)

Q. The United States National Bank was the executor?

A. Was executor of that estate, yes.

Q. Are you familiar with Petitioner's Exhibits Nos. 18 and 19?           A. Yes.

Q. Have you ever seen those before in connection with your duties?

A. Yes, sir, I have. They were assets of the estate of Herbert B. Miller.

Q. And they came into the possession of the United States National Bank?

A. As assets of his estate.

Q. Does the United States National Bank also, as trustee, [60] presently hold 100 shares of stock in the name of the Miller Paint Company, Inc.?

A. Yes, it does.

Q. In the same trust?           A. Same trust.

Q. That is, the Herbert B. Miller trust?

A. Yes, sir.

Q. That trust was set up under the last will and testament of Herbert B. Miller?           A. It was.

Q. Now, do you know D. W. McKay?

A. Yes, I did.

Q. Is he alive or deceased at the present time?

A. He is deceased at the present time.

Q. What was he, with the U. S. National Bank?

A. He was a trust officer of the United States National Bank.

Q. I hand you here a photostatic copy of Exhibit No. 24 and ask you to examine the signatures that appear thereon.

(Testimony of H. W. Moss.)

A. That is the initial of D. W. McKay.

Q. Is that the way he customarily affixed his signature? A. Yes, it was.

Q. And you recognize it?

A. I recognize it.

Q. Is it true that in the year 1946 you received from the [61] corporation, Miller Paint Company, a \$7,500 payment on one of these notes?

A. No. You say in the year 1946. He didn't die until 1948.

Q. That is right. I withdraw that question.

Have you received in your capacity as trustee of the estate of Herbert B. Miller any payments upon these notes?

A. We have on one of the notes, the \$28,000 note.

Q. Do you recall when the first payment that you received on those was made, in the trust?

A. It was received in 1949. It was around \$7,500. No. It was \$6,666.66.

Q. To what account did you deposit that \$6,666.66?

A. We deposited it to the principal of the trust account.

Q. Was that sum distributed to the widow?

A. No, it was not. Because it was income under the trust laws, under the rules of the trust instrument and under the laws of the state it was, remained principal.

Q. Now I hand you Petitioner's Exhibits Nos. 22 and 23 and ask you if you recognize what those are.

(Testimony of H. W. Moss.)

A. They are the 30-day letter and the 90-day letter sent to us by the Internal Revenue agent.

Q. With respect to 1949 deficiencies in income tax?

A. Yes, sir, in the amount of \$1,897.17.

Q. Did you pay this deficiency? [62]

A. We did. We paid it in May of 19— I have a note of it here—it was May of 1952—yes, May 8, 1952, we paid it, plus interest.

Mr. Miller: I will offer Petitioner's Exhibits Nos. 22 and 23 in evidence.

Mr. Welch: Respondent objects to these going into evidence on the grounds that they are neither relevant nor material. They are, in fact, photostatic copies of what they purport to be, 30-day and 90-day letters issued by the Internal Revenue Agent in charge, Seattle Division, addressed to the trust of Herbert B. Miller, deceased, in Portland, and they refer to the income tax liability for the year of 1949. That is the substance of my objection on it, it has no bearing upon this case before your Honor.

The Court: I doubt that they have any probative value here.

Mr. Miller: But they do show an outline, but they do show an outline, the problems, the thing that the estate faces. And we have in here the administrator—

The Court (Interrupting): I will admit them for whatever they may be worth. My present impression is that they may be worth very little.

Mr. Miller: I think that is a fair statement.

(Testimony of H. W. Moss.)

The Clerk: Petitioner's Exhibits 22 and 23 admitted.

(Petitioner's Exhibits Nos. 22 and [63] 23 received in evidence.)

Q. (By Mr. Miller): Does the trust have either one of these exhibits in its possession right at the present time, among the assets of the trust?

The Court: What are you handing to the witness?

Mr. Miller: I am handing to the witness Petitioner's Exhibits Nos. 18 and 19, being the notes payable to Herbert B. Miller, deceased.

A. The \$28,000 note has been paid off in full and returned to the Miller Paint Company, Inc. The \$29,000 note has not been paid and still is held by the trust.

Q. (By Mr. Miller): Have you ever attempted to enforce payment of the Miller Paint Company, of the \$29,000 note?

A. Which was due six years after date, which would make it June 1, 1952?

Q. Yes.

A. But in view of the fact that the Commissioner has contended that any payments on these notes represents a dividend, if the \$29,000 note were paid, the trust account would be assessed in excess of \$12,000 income tax, and also in view of the Commissioner's position, Mrs. Miller would also be subject to the same tax, on the same income, in excess of \$12,000. The total of the two taxes could easily wipe out the entire note.



(Testimony of H. W. Moss.)

Q. Are you receiving interest on this note regularly?

A. We are. Five per cent per annum. [64]

Q. And I take it, from your testimony, that you consider, on the basis of good trust management, you consider it good business not to enforce the payment of that note until the tax questions are settled concerning its nature?

A. That is correct.

Mr. Miller: That is all.

Cross-Examination

By Mr. Welch:

Q. Referring to Petitioner's Exhibit No. 19 in evidence, which is the document which you just testified about, you say that none of that principal amount has been paid by the Miller Paint Company? Is that correct? A. That is right.

Q. But the interest has been paid to date?

A. Yes, up to date.

Q. In accordance with the terms of the document? A. That is correct.

Q. Have you discussed payment of this note with the management of Miller Paint Company?

A. I can't testify as to that, because I am not the man who handles the account direct. But in view of the fact that I am one of the trust officers and handle the taxes, I am familiar with the account. But obviously we do not want the note to be paid until this tax question is settled, for the reason that we would receive nothing for it. [65]

(Testimony of H. W. Moss.)

Q. Do you know, of your own knowledge, whether anyone on behalf of the trustee, has requested Miller Paint Company to make payment?

A. I do, because I checked the files recently before I came up, to be sure that no demand had been made, and——

Q. (Interrupting): To your knowledge, there has been no demand?

A. To my knowledge, no demand has been made on it.

Mr. Welch: No further questions.

(Witness excused.)

The Court: We will reconvene at 10 o'clock in the morning.

(Whereupon, at 5:05 o'clock p.m., the hearing in the above-entitled petition was adjourned until 10 o'clock a.m., Tuesday, October 12, 1954.) [66]

The Clerk: We will now resume with the Herbert B. Miller case.

BLANCHE M. MILLER

was called as a witness by and on behalf of the petitioners, and having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Blanche M. Miller, 1700 North-east Irving.

Direct Examination

By Mr. Miller:

Q. Mrs. Miller, are you the widow of Herbert B. Miller, deceased? A. Yes, sir.

Q. Mrs. Miller, when and under what circumstances did you first learn of the illness of Mr. Herbert B. Miller, which eventually led to his death?

A. Well, it was in 1944, in August of 1944. He became ill, had an exploratory examination, operation, and it turned out to be cancer.

Q. Did you learn that from his doctor?

A. Yes, I did.

Q. At that time did you notify any of Herbert B. Miller's relatives?

A. Yes. I immediately called his brother.

Q. And that was which brother? [67]

A. Ernest Miller.

Q. Was Herbert B. Miller under continual treatment thereafter until his death in February, 1948?

A. Yes, he was. He was under observation and treatment all the time.

Q. What type of treatment did he have?

(Testimony of Blanche M. Miller.)

A. Well, he had X-ray treatments just periodically and he was in the hospital three weeks at one time with, what as I remember as mustard gas, it was an internal X-ray treatment. He just had treatments all during that period of time.

Q. Mrs. Miller, did you have any conversations with Herbert B. Miller, your husband, concerning his estate and the assets thereof?           A. Yes.

Q. About when did these conversations take place, just generally?

A. Oh, I would say—I don't remember the year. You mean the year?

Q. About, just the year about.

A. Well, one time, around the time he was making out his will, we talked about it a great deal.

Q. 1947?

A. It could have been. Yes, I would say it—that was one of the times we talked about it. We talked about it many times.

Q. In the conversations you had with Herbert B. Miller [68] concerning the assets of his estate, were the promissory notes which have been introduced in evidence here as Exhibits 15 and 16, in the amounts of \$28,000, \$29,000, respectively, ever mentioned?           A. Oh, yes.

Q. What did he tell you about these notes?

A. Well, from what he said, I understood that the notes were to go into the estate and that I was to get the income from them, benefits, whatever income there was from them, they were to be reinvested by the trust.

(Testimony of Blanche M. Miller.)

Q. By that, do you mean that you were to receive the entire notes, Mrs. Miller?

A. No, not at all. They were to go into the trust. And I was to receive the, whatever income there was from them, derived from the trust.

Q. In these conversations did you ever understand that you were to receive the principal amount of the notes? A. No, I did not.

Q. But that you were to receive the interest?

A. That is right.

Q. And the proceeds of the reinvested income?

A. That is right.

Q. Are you positive that was his understanding?

A. Yes, I am positive.

Q. Out of any of the payments made upon the principal of [69] these notes to the Herbert B. Miller trust, have you ever received in distribution of the trust any like amounts or similar amounts?

A. Would you say that again?

Mr. Miller: I will withdraw the question and rephrase it.

Q. (By Mr. Miller): Mrs. Miller, is it not true that at the time of the formation of the trust that there was still some monies due on the principal of the notes? A. Yes.

Q. It is your understanding that the bank has received some monies on those notes, that were paid on the principal? A. Yes.

Q. Were those sums of money distributed to you as life beneficiary of the income under the will?

A. You mean the notes, the money—

(Testimony of Blanche M. Miller.)

Q. (Interrupting): The money they received on the principal? A. No.

Q. I call your attention to the year 1949 and ask you if you recognize receiving this document, a 30-day letter with respect to the deficiency of income tax for that year?

A. Yes, I remember that.

Q. And then subsequent to that did you receive Petitioner's Exhibit No. 21, a 90-day letter, making demand upon you for payment [70] of income tax? A. Yes, I did.

Q. Do you recall what the particulars were of these, or why, what was the basis of these, of this, these deficiencies?

A. Well, they were supposed to have been tax on the note that I was supposed to receive, is that it?

Q. Was it the same thing that Mr. Moss testified to yesterday, a principal payment of \$6,666.66?

A. Yes.

Q. Did you receive that \$6,666.66?

A. No, I did not.

Q. Did you pay these deficiencies mentioned in these exhibits? A. Yes, I did.

Mr. Miller: Again, for the purpose of showing exactly what transpired here, and in line with the judge's ruling yesterday on Exhibits Nos. 22 and 23, we ask these be admitted into evidence.

Mr. Welch: I make the same objection, your Honor, that the 30-day and 90-day notices to this taxpayer, involving the taxable year 1949, are ir-

(Testimony of Blanche M. Miller.)

relevant and immaterial, so far as the issues in this case are concerned.

The Court: I am inclined to think that they have very little, if any, relevance, but I will permit them to go in for whatever they may be worth. [71]

The Clerk: This is 20 and 21, Petitioner's Exhibits 20 and 21 admitted in evidence.

(Petitioner's Exhibits Nos. 20 and 21 were received in evidence.)

### Cross-Examination

By Mr. Welch:

Q. Mrs. Miller, do you know of your own knowledge whether your husband was aware of the illness that you just testified about?

A. Well, I knew he knew he was very ill.

Q. Did he know the nature of his illness?

A. I don't know, I don't know whether he did or not. I didn't tell him.

Q. You didn't tell him? A. No, I didn't.

Q. You stated that he discussed with you the will that he was preparing?

A. Oh, yes, he did.

Q. Did you ever see the will?

A. Yes, sir.

Q. You saw it before he died?

A. I went over it many times with him.

Q. Did you ever discuss the will with his attorney? A. Yes, sir.

Mr. Welch: No further questions. [72]

(Testimony of Blanche M. Miller.)

Redirect Examination

By Mr. Miller:

Q. Did Herbert Miller and yourself have any children?           A. We had one son.

Q. And his name is——           A. Herbert.

Q. With respect to whether or not you told Herbert Miller about his condition, in '44 or any time thereafter, until 1948, were you under any instructions with respect to talking about his condition, with the deceased, Herbert B. Miller?

A. What?

Q. Did the doctor ever tell you to talk or not to talk to him about it?

A. To talk to him about it?

Q. Yes.           A. No, not necessarily.

Q. Did he give you any instructions either way about that?           A. No.

Q. It was just a subject that was never mentioned?           A. That is right.

Mr. Miller: That is all.

(Witness excused.)

Mr. Miller: With the Court's permission, I would like to recall Chester McCarthy to the stand to testify about a matter which has not been testified about before, in connection [73] with the, in particular connection with the, date of the execution of the will.

Do you have any objection?

Mr. Welch: For the limited purpose, I have no



objection. It is my understanding he will testify with respect to the last will and testament of Herbert B. Miller, which is in evidence. Is that right?

Mr. Miller: About its preparation and execution. That is, Exhibit No. 15.

Mr. Welch: There would be no objection for the limited purpose, as far as respondent is concerned.

CHESTER E. McCARTHY

was recalled as a witness by and on behalf of the petitioners, and, having been already duly sworn, was examined and testified further as follows:

Direct Examination

By Mr. Miller:

Q. Mr. McCarthy, on your previous direct examination, you testified that in the year 1946 you had conversations with Herbert B. Miller concerning the execution of his will. I hand you Exhibit No. 15, being a certified copy of the last will and testament, and call to your attention the date of the execution of that will. What date appears on that there?

A. 9 September, 1947.

Q. Is that the true date of the execution of his will? [74]

A. That is.

Q. Mr. McCarthy, have you any explanation for the fact that this will was not executed until the date that it bears, in line with your previous testimony that you had conversations back in the early part of the spring of 1946?

A. Yes, I started working on Mr. Miller's will early in '46, well, not early in '46, but the middle of

(Testimony of Chester E. McCarthy.)

the year of '46, immediately upon the completion of the corporation's organization, and it was rewritten time and time again. It was one of those occasions where the rough draft was made. Herbert Miller would come into the office, have a change of mind on such items, as, oh, at what age his son should come into a portion of the trust estate, for instance, that was changed one or two times that I recall. Also a question arose of a change on what age he would get the stock of the Miller Paint Company, a couple of changes on that. He would come in and we would make another rough draft. And then there might be two or three weeks or maybe a month before he would come in again. Some of these meetings, not at first, but along towards the latter portion of that period during which this will, and the trusts therein contained were being drafted, Mrs. Miller came to the office. There were certain things that I advised him that I thought she ought to know about before his death or before the will came into being as a document, so there would be a minimum of friction between his widow, upon his death, and his [75] surviving brothers and his son, so that she would thoroughly understand what he intended to do by his tying up of the estate, in his terms, in the manner which he did in the trust. These things were all explained to Mrs. Miller in his presence, by me and by him. After the document was in a shape that it was satisfactory to him, and I thought met the legal requirements, I suggested that inasmuch as the trustee was the United States National

(Testimony of Chester E. McCarthy.)

Bank, which would be operating, or executing that portion of it, that perhaps before its execution the United States National Bank trust department ought to take a look at it and offer any suggestions they might have, that should be incorporated to facilitate the administration of the trust after it got into their hands. That was done and considerable time was taken up in that particular transaction.

If you want it, I could tell exactly——

Q. (Interrupting): Mr. McCarthy, do you keep time records?

A. In the law office, I did. I have a record here, well, all of these places where the paper clips are (indicating) were to indicate time or days upon which the Millers or some of them were in the office, in the latter part of '46, and these items in '47, many of them are in conjunction with the will of Herbert B. Miller. The last entry I have on that is on September 9, 1947, when Herbert Miller was in the office concerning his will between 2:30 in the afternoon and 4:30 in the afternoon. And that is the date the will was executed. [76]

Q. Could you tell the Court the first time that Herbert B. Miller brought up the question of his will, as noted from your time records?

A. It is possible that I can. These time records are exactly what the name implies. They are not made for the purpose of taking notes from which later to testify. They are merely records of time so that fair charges could be made for the time, and not in all of these, you never put down in detail, and not always exactly what the matter was

(Testimony of Chester E. McCarthy.)

about. For instance, a lot of these conversations were commingled with conversations concerning the Miller Paint Company business. Well, the first conversations I had with Miller Paint Company, don't think the date, this was the date which the will was brought up, April 16.

Mr. Welch: I think the witness is on here for a limited purpose, and I wish you would have him instructed that he should respond to the question. The question is, as I understand it, what was the first time that Herbert Miller came in to talk to you about making out a will, and I think his answer should be limited to that, if he knows.

The Court: Can you answer that?

The Witness: I can answer that in this way, your Honor, they were in the office on numerous occasions and I can't pinpoint any one day when he came in to talk exclusively about the will. This was all mixed up in one general transaction, in getting his estate and the estate's— [77]

The Court (Interrupting): To the best of your recollection.

The Witness: It was early, about the middle of '46.

Q. (By Mr. Miller): I think the question was, as it would appear from the time records, what was the first time that you talked concerning the will.

A. Let's see if I have anywhere that says "will" here. Yes, the first entry I have here, where I put the notation "wills" down, is on the 19th day of

(Testimony of Chester E. McCarthy.)

June, 1946. Miller was in my office between 1:20 and 1:55 on that date. And the subject of, I have here "continued," so I must have had some conversations prior to that time concerning it, but this is the first notation I have where I have identified it as predominantly "wills," June 19, 1946.

Mr. Miller: You may cross-examine.

Mr. Welch: I have no questions, your Honor.

(Witness excused.)

Mr. Miller: Petitioner rests, your Honor.

Mr. Welch: I want to make a brief statement before the respondent rests.

In examining the stipulation of facts, I find what appears to be a typographical error. I want to demonstrate to the Court precisely what it is. It's a part of paragraph 13 of the stipulation of facts, on page 7, the fourth line, under the column in the tabulation, headed "November 30, 1946," [78] which is designated "income tax liability" there appears the figure \$9,224.02. It was my intention in preparing this that this figure read \$6,224.02. And that figure of \$6,224.02 was taken from Exhibit I, which is a copy of a revenue agent's report, incorporated in a 30-day letter.

Mr. Miller: There is no objection to stipulating to change that.

Mr. Welch: Just so there is no conflict between the two figures.

The Court: I will hand you the original copy of the stipulation which has already been received.

You may make the change in pen and ink and both counsel will initial it at the change, in the margin.

Mr. Welch: Respondent rests, your Honor.

The Court: The petitioner's brief will be due in 45 days. Respondent may answer in 30 days. And petitioner, in turn, will have 20 days within which to reply to respondent.

I would like to have from the respondent, in his brief, a clearer statement than I have received thus far from the government as to just why these payments on the notes are said to constitute dividend income—this case has been described to me by counsel in their opening statements as a case involving two issues—which would undertake to answer that question, namely, one, whether there was a Section 112 (b) (5) change, and, secondly, whether these notes were stock rather than debt, and [79] an issue that has been described colloquially as one relating to “thin incorporation”—that is not a statutory term, it's a colloquial term. There is still a long step from either of those two issues, to the question before me, namely, whether these payments or notes constitute dividends, and I would like to see that long step spelled out with considerably greater clarity than has been presented thus far. Conceivably this might be a 112 (b) (5) change and conceivably this might be stock or notes. There is still a question that goes beyond that, as to how you convert payments on these notes into dividends, and I would like to have that spelled out with greater clarity than has been done thus far for me.

Mr. Welch: It is my intention to do that, your Honor, on brief. I am aware that there are some

unique features to the respondent's determination in this proceeding, and at the present time I think there are only two citations of authority upon which I can show your Honor——

The Court (Interrupting): I am not asking you for a citation of authority at this point. I am asking you to spell out the theory of your case. You can undertake any kind of citations you want to. But I want to see the theory of your case, as to how you convert these payments upon the principal of the notes, into dividends, into receipt of dividends.

Mr. Welch: Yes, your Honor.

The Court: I don't quite see at this point how you [80] take that step, even if you should prevail upon these two so-called preliminary or two issues you have been apparently attempting to try before me. Now, perhaps you can do it, and perhaps I have not been as alert as I should have been, but I have attentively listened to the testimony and I have examined the evidence as it has come in, and I am by no means clear as to just how you would undertake to justify that final step of treating these payments as dividend income. And I expect you in your brief to make a clear-cut analysis and show me just what the theory of your case is.

Mr. Welch: Yes, sir.

The Court: The case is submitted.

(Whereupon, at 10:35 o'clock a.m., the hearing in the above-entitled petition was closed.)

[Title of Tax Court and Cause.]

Certificate

I, Howard P. Locke, Clerk of The Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 19, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Designation of Contents of Record on Review" and "Designation of Additional Portions of Record," excepting exhibits 1-A thru 7-G, H, I, 8-J, 9-K, 10-L & 11 thru 16 attached to the Stipulation of Facts and Petitioner's Exhibits 17 thru 28 admitted in evidence, which are separately certified and forwarded herewith, as the original and complete record in the proceedings before The Tax Court of the United States entitled: "Estate of Herbert B. Miller, deceased, The United States National Bank of Portland (Oregon), Administrator, d.b.n., c.t.a., Petitioner, v. Commissioner of Internal Revenue, Respondent, Docket No. 28582" and "Estate of Herbert B. Miller, deceased, The United States National Bank of Portland (Oregon), Administrator, d.b.n., c.t.a., Petitioner, v. Commissioner of Internal Revenue, Respondent, Docket No. 31062," and in which the petitioner in The Tax Court proceeding has initiated appeals as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States,





In the United States Court of Appeals  
for the Ninth Circuit

Docket No. 15031

Estate of HERBERT B. MILLER, Deceased, THE  
UNITED STATES NATIONAL BANK OF  
PORTLAND, (Oregon), Administrator, d.b.n.,  
c.t.a.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### MOTION FOR CONSOLIDATION ON APPEAL

Comes Now the Estate of Herbert B. Miller, Deceased, The United States National Bank of Portland, (Oregon), Administrator, d.b.n., c.t.a., petitioner, and moves that the proceedings in Tax Court Docket Nos. 28582 and 31063, both captioned as above, be consolidated for the purpose of printing of record, briefing, hearing, argument and decision and for cause therefor, respectfully represent to the Court as follows:

1. The issues of fact and of law in each of the above-mentioned Tax Court Docket Nos. 28582 and 31063 are identical.

2. The proceedings in each of said docket numbers were consolidated before the Tax Court for trial, briefing and decision.

Wherefore, it is prayed that this motion be granted.

/s/ GEORGE W. MILLER,  
Attorney for Petitioner.

Consented to:

/s/ CHARLES K. RICE,  
Acting Assistant Attorney General, Attorney for  
Respondent.

So ordered:

/s/ WILLIAM DENMAN,  
Chief Judge;  
/s/ WM. HEALY,  
/s/ WALTER L. POPE,  
United States Circuit Judges.

[Endorsed]: Filed February 20, 1956, U.S.C.A.

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[Title of Court of Appeals and Cause.]

**STATEMENT OF POINTS ON APPEAL AND  
DESIGNATION OF RECORD**

Comes Now the Petitioner on Review and for its Statement of Points on Appeal, designates and adopts the Statement of Points as filed in Docket Nos. 28582 and 31063 in the Tax Court of the United States and as certified to by the Clerk of the Tax Court and heretofore filed with the above-entitled Court; and

Petitioner on Review does hereby designate as the Record on Review the Designation of Contents of Record on Review filed by Petitioner on Review and the Designation of Additional Portions of Record filed by Respondent on Review in Docket Nos. 28582 and 31063 in the Tax Court of the United States and as certified to by the Clerk of the Tax Court and heretofore filed in the above-entitled Court; and

Petitioner on Review relies upon all exhibits and the pleadings in Docket No. 31063, herein designated, in their original form whether or not printed in the Transcript of Record in the above-entitled Court.

Dated this 10th day of February, 1956.

McCARTY, SWINDELLS,  
MILLER & McLAUGHLIN,  
DAVID S. PATTULLO,  
GEORGE W. MILLER,  
/s/ GEORGE W. MILLER,  
Of Attorneys for Petitioner  
on Review.

Service of copy acknowledged.

[Endorsed]: Filed February 21, 1956, U.S.C.A.

[Title of Court of Appeals and Cause.]

### STIPULATION RE PRINTING OF RECORD

It Is Hereby Stipulated between the Commissioner of Internal Revenue, Respondent on Review, by his attorney, Charles K. Rice, Acting Assistant Attorney General, and the Estate of Herbert B. Miller, Deceased, The United States National Bank of Portland, (Oregon), Administrator, d.b.n., c.t.a., Petitioner on Review, by George W. Miller, its attorney, subject to the discretion of the above-entitled Court:

1. That the Clerk of the above-entitled Court may include in the printed Transcript of Record only the pleadings designated by the parties in Tax Court Docket No. 28582 and may exclude the pleadings in Tax Court Docket No. 31063, it being recognized that the pleadings in each of said docket numbers are substantially identical.

2. That any decision on appeal in the above-entitled Court, based upon the pleadings in Tax Court Docket No. 28582 shall be determinative in the proceedings relative to Tax Court Docket No. 31063 in the same manner as if the pleadings therein were printed in the Transcript of Record.

3. That all exhibits designated by the parties as part of the Record on Appeal, although relied upon by the parties in their original form, need not be printed in the Transcript of Record.

Dated this 10th day of February, 1956.

/s/ CHARLES K. RICE,  
Acting Assistant Attorney General, Attorney for  
Respondent.

/s/ GEORGE W. MILLER,  
Of Attorneys for Petitioner  
on Review.

[Endorsed]: Filed February 21, 1956, U.S.C.A.